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IN THE MATTER OF:)

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DETERMINATION OF ROYALTY) Docket No.

RATES AND TERMS FOR) 16-CRB-0001-SR/PSSR

TRANSMISSION OF SOUND) (2018-2022)

RECORDINGS BY SATELLITE)

RADIO AND "PREEXISTING")

SUBSCRIPTION SERVICES)

(SDARS III))

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14 BEFORE: THE HONORABLE SUZANNE BARNETT

15 THE HONORABLE JESSE M. FEDER

16 THE HONORABLE DAVID R. STRICKLER

17

18 Library of Congress

19 Madison Building

20 101 Independence Avenue, S.E.

21 Washington, D.C.

22 April 26, 2017

23 9:07 a.m.

24 VOLUME V

25 Reported by: Karen Brynteson, RMR, CRR, FAPR

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3 of Musicians of the United States and Canada, Screen
4 Actors Guild and American Federation of Television
5 and Radio Artists, American Association of
6 Independent Music, Universal Music Group, Warner
7 Music Group, RIAA:

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9 STEVEN R. ENGLUND, ESQ.

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1 P R O C E E D I N G S

2 (9:07 a.m.)

3 JUDGE BARNETT: Good morning. Please be
4 seated.

5 You might have detected that we are not
6 all at the peak of health, so if you have hand
7 sanitizer, you should use it.

8 Are we ready for cross-examination --

9 MR. RICH: We are, Your Honor.

10 JUDGE BARNETT: -- of this witness?

11 Whereupon--

12 JONATHAN ORSZAG,
13 a witness, called for examination, having previously
14 been duly sworn, was examined and testified further
15 as follows:

16 JUDGE BARNETT: Let me just ask,
17 Mr. Fakler, do you have any questions for this
18 witness?

19 MR. FAKLER: No, Your Honor. Thank you.

20 JUDGE BARNETT: Okay. Then, Mr. Rich,
21 it's all you.

22 MR. RICH: Thank you. I'll keep my
23 distance, Your Honor.

24 CROSS-EXAMINATION

25 BY MR. RICH:

- 1 Q. Good morning, Mr. Orszag.
- 2 A. Good morning, Mr. Rich.
- 3 Q. You testified you have a Master's in
- 4 economics and social history; is that correct?
- 5 A. That is correct.
- 6 Q. And that you, in your words, made a
- 7 decision not to pursue a Ph.D.; is that correct?
- 8 A. That is correct.
- 9 Q. And as a result, you do not hold a Ph.D.
- 10 in economics; is that right?
- 11 A. That is correct.
- 12 Q. Or in any other academic field?
- 13 A. That is correct.
- 14 Q. All right. And you've done a couple of
- 15 teaching stints; I believe you testified?
- 16 A. Yes, sir.
- 17 Q. All right. And am I right that one of
- 18 those was during the summer of 1997 at a prep
- 19 school?
- 20 A. I went back to my high school to teach,
- 21 yes, sir.
- 22 Q. And the second was one academic semester
- 23 in 2002 at USC?
- 24 A. That is correct.
- 25 Q. As an adjunct lecturer?

1 A. That is correct.

2 Q. Okay. Now, in your consulting capacity,
3 you've provided testimony in other court and
4 administrative proceedings?

5 A. That is correct.

6 Q. A number of which you listed on your
7 curriculum vitae, yes?

8 A. I believe everything that I've testified
9 in is listed there.

10 Q. Okay. And that was my next question. I
11 didn't see, but it's entirely possible that I missed
12 it, your work on behalf of AEtna and Humana in
13 relation to a government challenge to the proposed
14 merger of those health insurance companies on
15 antitrust grounds. Is that in your resume?

16 A. It -- that case, I believe, was after
17 this one was filed, but my updated resume has that
18 information.

19 Q. Okay. I'm not sure it made it into your
20 -- well, let me just be clear. So do you recall
21 when your work began on that engagement?

22 A. Well, the beginning of it was June of
23 2015. The reports were filed sometime in the fall
24 of 2016 with the trial in, I believe, it was
25 December of 2016, and so I had a report, I think --

1 I'm going to say I had a report on November 1st, and
2 that's it.

3 Q. Okay. And the trial was -- as you point .
4 out, it was in December. That would have been
5 before you submitted your amended written direct
6 testimony here on January 5th; is that right?

7 A. The trial, yes, sir.

8 Q. Okay. And prior to yesterday's
9 appearance here and today's, was that your most
10 recent testimonial experience?

11 A. Other than the deposition in this case, I
12 believe that to be the case, although on my web
13 site, it has my current CV, so if there was another
14 written testimony, it would be in there.

15 Q. I meant sort of live, in-person
16 testimony.

17 A. Oh, the only -- yeah, that last thing was
18 the Aetna/Humana matter.

19 Q. Yeah. I take it you're aware of the
20 ensuing decision by the Federal District Court which
21 was issued in January of this year; is that correct?

22 A. That is correct.

23 MR. RICH: And the case, for Your Honors'
24 information, is styled United States versus Aetna
25 et al. I can only provide a Westlaw cite at the

1 moment, which is 2017 Westlaw, beginning 325189,
2 opinion issued I believe right here in the District
3 Court in the District of Columbia, January 23rd of
4 this year.

5 THE WITNESS: Yeah, from Judge Bates.

6 BY MR. RICH:

7 Q. Okay. And am I correct that in that
8 decision, the Court determined that the government
9 had established a prima facie case that the proposed
10 merger would substantially lessen competition in the
11 relevant market there?

12 A. That is -- I mean, precise legal words --

13 Q. Understood.

14 A. -- as an economist -- they -- the judge
15 ruled to block the merger.

16 Q. Fair enough. And that the effort by the
17 two companies to submit sufficient pro-competitive
18 attributes did not ultimately carry the day before
19 the Court?

20 A. That is correct.

21 Q. All right. And on behalf of the proposed
22 merging companies, you presented testimony on the
23 probable economic effects of the merger; is that
24 correct?

25 A. That is correct.

1 Q. In support of which you testified as to
2 matters relating to market definition?

3 A. That is correct.

4 Q. As to the proper method for applying the
5 so-called hypothetical monopolist test?

6 A. That is one of the issues I testified on.

7 Q. Can you tell the Court what the
8 hypothetical monopolist test is, please, in simple
9 terms?

10 A. I'll do the one- or two-sentence version,
11 and then if anybody wants more detail, I'm more than
12 happy to provide it. In merger analysis, in
13 competition analysis, a key question is what is the
14 relevant antitrust market? And the method that is
15 used by economists is the hypothetical monopolist
16 test, which assumes that there is a hypothetical
17 monopolist over the putative product, or if the
18 product is, let's say in this case, Medicare
19 Advantage, so that's health insurance for elderly
20 Americans that's provided -- privately provided, you
21 assume a hypothetical monopolist and you test
22 whether if that hypothetical monopolist raised
23 prices by 5 to 10 percent, whether that would be a
24 profitable endeavor.

25 If it's profitable, that is a properly

1 defined relevant market. If it's unprofitable for
2 that hypothetical monopolist to do it, then the
3 market is incorrectly specified.

4 Q. Thank you. And I take it that some or
5 all of that principle is set out in the DOJ
6 Horizontal Merger Guidelines?

7 A. It is all set out in the Horizontal
8 Merger Guidelines.

9 Q. Okay. And I take it that another aspect
10 of your testimony in that litigation bore on the
11 subject of the relationship between market
12 concentration and prices in the relevant market; is
13 that correct?

14 A. That is correct. I did an econometric
15 analysis of that issue.

16 Q. Now, the District Court rejected the
17 market definition you proposed in favor of the
18 government's proposal; is that correct?

19 A. That is correct.

20 Q. And the judge found that at least a part
21 of your analysis was "almost entirely speculative"?

22 A. I think that quote actually -- he said
23 that about both experts because neither of us had
24 information on a point that we were making, so he
25 said Professor Nevo, who testified on behalf of the

1 government, and I both had to speculate about that
2 point. And so he -- he moved on to then other
3 factors.

4 Q. The Court similarly found that the
5 regressions you ran to support the limited extent of
6 head-to-head competition between the two companies
7 was of "limited" persuasive value; is that correct?

8 A. I don't remember the precise quote, but
9 I'm not going to argue with you that he used those
10 words.

11 Q. And that the analysis you presented
12 demonstrating the ease of entry in the market
13 demonstrated "circular reasoning" that assumed its
14 conclusion?

15 A. Yeah, I actually disagree with his
16 discussion there, but it's a relatively minor point
17 in the overall analysis of the issue. If you're
18 going to pick up quotes, you should maybe want to
19 pick up other quotes about how he pointed to
20 analyses that were correct and analyses where he
21 said that it was helpful to the Court to present
22 them that way.

23 Q. Well, I'm sure Mr. Handzo could
24 rehabilitate that in any fashion he -- he sees fit.
25 But I didn't misquote the judge in any of the quotes

1 I cited, correct?

2 A. I didn't memorize the decision, so I
3 can't give -- I can't -- but I'm not going to
4 disagree with you.

5 Q. Okay. Now in A-10 of your appendix,
6 which is your vitae, you list another testimonial
7 experience, this one four bullets from the bottom,
8 In re Electronic Books Antitrust Litigation, State
9 of Texas et al. v. Penguin Group; is that correct?

10 A. That is correct.

11 Q. And, colloquially, a number of folks
12 think of that as the E-books antitrust case,
13 correct?

14 A. Yes, sir.

15 Q. And am I correct that that involved
16 price-fixing claims asserted against Apple and
17 Google book publishers in relation to the sale of
18 E-books?

19 A. That is correct.

20 Q. And you served in that matter as an
21 expert for Apple and prepared, as you note in your
22 resume, several expert declarations?

23 A. That is correct.

24 Q. Okay. Now, those were the subject of
25 Daubert motions directed to the various opinions you

1 put forward; is that also true?

2 A. On certain matters, yes, and on certain
3 matters, no.

4 Q. Yes. And I take it you're familiar that
5 the District Court Judge Cote, in the Southern
6 District of New York, granted that motion as to what
7 she characterized as three of the four principal
8 sets of opinions that you put forward; is that also
9 correct?

10 A. I don't remember the precise language.
11 The way I think about it is I had two major
12 analyses; I had an econometric analysis, which she
13 -- she accepted, and then there was an offsetting
14 analysis in terms of outside the relevant market,
15 which she rejected as a matter of law and then she
16 criticized. And there were components of that
17 offsetting analysis, so that was put to the -- so
18 the way I've always thought about it is two parts,
19 and she accepted the econometric analysis and she
20 rejected and then criticized the other analysis.

21 Q. And with respect to the analysis that she
22 criticized, she found that one aspect of it was
23 "unmoored from record facts and unsupported by any
24 rigorous analysis"; is that your recollection?

25 A. She had quotes like that. I -- I don't

1 remember the precise words.

2 Q. And that she said it reflected a
3 hypothesis that rested on "layers of assumptions,
4 many of which are untethered to the real world or at
5 odds with the facts"; correct?

6 A. Those were her words, yes, sir.

7 Q. That it purported to measure the effect
8 of competition within the E-reader market without
9 undertaking an examination of that market or
10 performing a study? Correct?

11 A. I don't have it in front of me so I can't
12 -- I didn't memorize the decision.

13 Q. Do you recall her characterizing it as
14 inviting, engaging in guesswork?

15 A. I don't remember those precise words.
16 It's not something I committed to memory.

17 Q. Okay. That's fair.

18 Now, before we turn to the bases for the
19 opinions you offer in this proceeding, let me see if
20 the following statements fairly capture the essence
21 of the affirmative opinions you're setting forth as
22 to the setting of rates. And this is really
23 intended just to fairly summarize, at least, and
24 boil down several of those. And you can feel free
25 to round them out in any way you'd like.

1 The first is that you agree that the
2 rates to be set here by the Judges with due regard
3 for the 801(b) factors must reflect the workings of
4 effective competition; is that correct?

5 A. I can agree to that proposition, yes,
6 sir.

7 Q. Okay. You proposed, as the optimal
8 benchmark for rate setting, the rates reflected in a
9 current body of license agreements, 27 to be exact,
10 entered into between the major record companies and
11 subscription interactive services. Is that also
12 correct?

13 A. Yes, sir.

14 Q. You recognized that the Judges in Web IV
15 found that the upstream market for licensing such
16 interactive services featured complementary
17 oligopoly conditions and a complete lack of price
18 competition between and among record companies for
19 increased shares of plays on such services? Is that
20 correct?

21 A. I think the general description is -- is
22 directionally correct at that time; I would have to
23 add --

24 Q. At that time.

25 A. -- at that time, although the precise

1 words for that I defer to the decision itself.

2 Q. Fair enough. You nevertheless have
3 concluded that competitive conditions in that
4 licensing market have improved such that that market
5 is increasingly effectively competitive? Is that a
6 fair characterization?

7 A. The -- the trends point in that
8 direction, yes, sir.

9 Q. You believe that the Judges in Web IV
10 broadly validated the concept of ratio equivalency
11 and that the approaches to rate setting reflected in
12 your approaches 1 and 2 accurately implement that
13 principle? Is that fair?

14 A. That methodology, yes, sir.

15 Q. You also believe that since the time the
16 Judges in Web IV set the rate for statutorily
17 compliant subscription webcasters, based on the
18 contract per-play rates drawn from a series of
19 interactive license agreements, market conditions
20 have evolved; and current marketplace evidence,
21 including recent agreements entered into by Pandora
22 and iHeart for mid-tier service, warrant adopting
23 rates at the levels you propose?

24 A. I would just articulate that slightly
25 differently --

1 Q. Please do.

2 A. -- if I may.

3 Q. Please do.

4 A. I would just -- my analysis focuses on
5 current market conditions. And so I'm analyzing
6 what the market looks like today.

7 As I think I've expressed, I wasn't part
8 of the Web IV decision. So what was in place at
9 that time, I defer to the record and others. So
10 what I'm looking at is what's the current market
11 conditions.

12 And to the extent that they show
13 something different than what is presented in the
14 Web IV decisions, say, then the assumption is that
15 the market conditions have changed because I have
16 not done a detailed analysis looking at how the
17 market has changed. I'm looking at -- I'm -- I'm
18 starting from a blank slate in some sense of what
19 are the market agreements in place today that should
20 govern the ratio equivalency today.

21 Q. You would agree with me, however, that
22 sprinkled throughout your written direct and
23 rebuttal testimony are references to the prior time
24 periods and agreements as obsolete, dated, and not
25 reflecting current market conditions, correct?

1 A. That is correct. So, for example, I talk
2 about how the Pandora/Merlin deal is now obsolete
3 because there is a newer deal in place. I talk
4 about how the fact that there is increasingly
5 connected cars and so that is forcing convergence,
6 and -- and those are facts that I have gleaned from
7 the record evidence in this case.

8 Q. And the last base point I just want to
9 set forward -- and I don't mean to suggest you have
10 nothing else as part of your case, but these are
11 sort of distillations for my purposes -- that if,
12 but only if the Judges conclude that a steering
13 adjustment remains warranted to compensate for
14 remaining differences in the competitive conditions
15 observed in the benchmark and target markets, they
16 should employ a steering adjustment up to
17 12 percent?

18 A. Or that's within the reasonable range,
19 yes, sir.

20 Q. Okay. So I'd like to now examine the
21 bases for certain of those opinions. Let's start
22 with the state of competition in the interactive
23 services market.

24 Now, you've been retained here by the
25 same litigating party, SoundExchange, as litigated

1 Web IV for the record industry, correct?

2 A. I believe that to be the case, but it's
3 not something I studied at that -- whether there
4 were other parties, I'm not sure.

5 Q. You understand, for example, that the
6 same major labels who were involved as litigants in
7 the Web IV proceeding are equally involved in this
8 proceeding, correct?

9 A. Yes, I do understand that.

10 Q. And you've been given access to
11 knowledgeable executives at those labels to give you
12 pertinent background for your testimony, correct?

13 A. That is correct. I interviewed a number
14 of the executives at the various major labels.

15 Q. Right, and so you indicated in your
16 written direct testimony. And while you assert that
17 the interactive service market has become
18 increasingly workingly competitive, you never asked
19 those senior executives with whom you met whether
20 the companies engage in price competition in
21 licensing interactive services, did you?

22 A. You know, that was not the topic of the
23 -- my conversation with those business executives.

24 Q. So you didn't inquire either currently or
25 back in time, including as of Web IV, whether they

1 were aware of the degree of such price competition?
2 You say that wasn't something you were inquiring
3 about, correct?

4 A. That is correct.

5 Q. And while you assert that the interactive
6 service market has become increasingly workingly
7 competitive, you cite no evidence of any price
8 competition, in the form of steering to induce
9 greater market share, having emerged in that market
10 since the time of the Web IV decision, do you?

11 A. Well, except for -- and I talked about
12 this in my direct testimony; I remember yesterday, I
13 guess I should say -- the presence in the Pandora
14 and iHeart deals of an anti-steering provision in
15 one and no anti-steering provision in another, and
16 how that influenced their decisions per the business
17 executives.

18 JUDGE STRICKLER: I have a question for
19 you, sir. Those anti-steering provisions that --
20 that you're saying were not there, and that by
21 contrast were there in other agreements, do those
22 refer to steering in the -- in the downstream market
23 or the upstream market? Or both or neither?

24 THE WITNESS: So the -- the provision in
25 the Pandora deal -- and I didn't commit it from

1 memory so I'm doing this from memory -- says that --
2 something to the effect -- and we can get the actual
3 document if we want to look at it precisely -- that
4 Pandora will ensure that -- that the amount of plays
5 for a particular label, so let's just say -- is
6 this?

7 MR. HANDZO: Sorry, Your Honor. I think
8 since we're talking about specific terms in the
9 agreement, this is probably restricted information.

10 JUDGE BARNETT: We will -- we'll close
11 the doors.

12 (Whereupon, the trial proceeded in
13 confidential session.)

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1 O P E N S E S S I O N

2 BY MR. RICH:

3 Q. Let's turn to the topic of convergence
4 next. You consider subscription interactive
5 services to be the best available benchmark for
6 satellite radio due to the comparability of the two
7 types of service along key dimensions? Is that
8 correct?

9 A. That's a fair description, yes, sir.

10 Q. Okay. And in your written direct
11 testimony, you state, paragraph 30, I want to get it
12 near you, "Importantly, there is no difference
13 between interactive streaming services and satellite
14 radio in terms of the music content they deliver to
15 subscribers."

16 Do you see that?

17 A. Yes, sir.

18 Q. The point you're making here, I take it,
19 is simply that both Sirius XM and interactive
20 services perform music, right?

21 A. Correct. Well, they don't technically
22 perform the music. They distribute it.

23 Q. Distribute music for performance. Thank
24 you. And that comparability doesn't make the
25 interactive services a better benchmark than any

1 other form of music distribution, does it?

2 A. Well, it does for -- relative to some
3 benchmarks, and that's the point. That's why I
4 excluded, for example, Services that were more
5 narrowly tailored in terms of their music
6 repertoires. So, for example, the -- the classical
7 music service would not be an appropriate benchmark
8 for something like Sirius XM, which is offering the
9 full repertoire of music.

10 Q. But insofar as you just, I believe,
11 agreed with me, that the limited point you were
12 making, as far as this element goes, is that both
13 Sirius XM and interactive services distribute music?
14 That's not a very narrowing conception of
15 competition, is it?

16 A. No. And I'm not claiming -- trying to
17 claim that -- this does not exclude all other
18 benchmarks, this one sentence in and of itself, for
19 sure.

20 Q. Okay. So let's keep going. In paragraph
21 32 of your written direct testimony, you set forth
22 some other key respects, as you put it, in which
23 Sirius XM and interactive subscription services are
24 similar.

25 Am I correct about that?

1 A. Yes, sir.

2 Q. All right. And in that paragraph, you
3 assert that Sirius XM and subscription interactive
4 services have "increasingly converged"?

5 A. Yes, sir.

6 Q. And in support of that proposition, you
7 point out that interactive services offer "lean-back
8 functionality as well as algorithmic streams,"
9 correct?

10 A. That is correct.

11 Q. Now, those are both ways in which, I
12 think you would agree with me, subscription
13 interactive services have become more like Sirius
14 XM, correct?

15 A. That is correct.

16 Q. But you don't list any ways in which
17 Sirius XM has become more like subscription
18 interactive services, correct, in terms of its own
19 change?

20 A. Not here I do not, no.

21 Q. And that's because Sirius XM's service
22 hasn't changed; isn't that correct?

23 A. So let's pause on that for a second, if I
24 may, and say that the satellite service in terms of
25 the music content, the non-music content, I have not

1 ascertained significant changes in -- in a long
2 period of time.

3 Obviously, they've added new
4 functionality that, with the subscription, you can
5 get, for example, service -- if you pay for a
6 certain -- at a certain price, you get service via
7 an app A service as well. That years ago was not
8 available. So there have -- have been those changes
9 to get more mobility if you are a subscriber at a
10 certain level to Sirius, which would then bring it
11 closer together to the interactive services.

12 So -- I know this proceeding is a only
13 about the satellite part of it --

14 Q. Right.

15 A. -- but with the subscription, they are
16 providing consumers functionality that bring those
17 together in terms of the consumer perspective.

18 Q. But with respect to the satellite part of
19 it, you've not identified any convergence towards
20 interactive services; the convergence, as you term
21 it, has been one way, correct?

22 A. But when you're a consumer, you don't
23 focus -- at least there's not evidence that they
24 focus on the mode of transmission, and so when you
25 offer a consumer now the option to also subscribe --

1 when you subscribe at a higher level, you get
2 additional functionality like having an app with
3 music on it, that provides a benefit to the consumer
4 bringing from the consumer perspective the Sirius XM
5 option closer together to the -- to the interactive
6 option.

7 Q. The changes you describe on the part of
8 interactive services is away from interactivity
9 towards less interactive streams of record label
10 sound recordings, correct?

11 A. It's -- it's in response to consumer
12 demand. Consumers are increasingly using the
13 lean-back functionality more so than -- so I think
14 we have to -- the consumers are driving a lot of
15 this behavior.

16 Q. Right. Less, rather than more,
17 interactivity on the part of the consumers, correct?

18 A. That consumers are looking for --
19 consumers are using the product in such a way.

20 Q. Now, notwithstanding the direction of
21 that market change, it's your opinion that Sirius
22 XM's rate should immediately more than double,
23 correct?

24 A. Well, I don't agree to the proposition
25 about the calculation of the numbers for the reasons

1 I articulated yesterday. But what I'd say is that
2 if you use current market-based rates, the rate is
3 as I described in my direct testimony or in my
4 presentation.

5 Q. But we're not doing this completely in a
6 vacuum; you would acknowledge that the immediate
7 impact of adopting your rates would be to more than
8 double the rates Sirius XM is currently paying,
9 correct?

10 A. The -- the rates at Sirius XM would
11 increase by roughly double. And given there are
12 very high margins, and Professor Lys has a
13 significant amount of information in his testimony
14 about this, they have more than enough financial
15 wherewithal to withstand such an increase in cost.

16 Q. So you're recommending to the Judges that
17 based on Sirius XM's ability to pay, they should
18 rule in this proceeding?

19 A. That's not -- that's a consideration.
20 When one determines market rates, the analysis of
21 the 801(b) factors would suggest that one
22 consideration would be whether those market rates
23 would be sustainable for a new or emerging business,
24 but as you're proposing or discussing, it seems to
25 me, you're seeming to suggest that if one gave -- if

1 one had to decrease the rate in the past because it
2 was a new or emerging business, there should -- that
3 -- that should never change.

4 And if that's -- that departure from
5 market rates had been significant in that first time
6 period, you're suggesting by your question, I think,
7 that there should -- that that should never be
8 undone.

9 From an economic perspective, that would
10 then be inconsistent with the 801(b) factors. And
11 what you really should be moving towards is to the
12 market rates. And those market rates are what I
13 calculated here in this matter.

14 Q. I'm only asking questions. I'm not
15 suggesting. There are times when the Judges do see
16 me suggest. I'm only asking questions.

17 But I'm puzzled because you seem to be
18 coming back to an assumption, which is that the
19 rates set in the SDARS II proceeding were a knowing
20 reduction below otherwise fair market value on
21 account of the financial condition or lesser ability
22 to pay on the part of Sirius XM. Is that your --

23 A. What I'm --

24 Q. Is that your take away from SDARS II,
25 which you haven't read in a year?

1 A. What I said, and I'll repeat again, is
2 twofold. First of all, I'm looking at current
3 market rates. Current market rates suggest that the
4 percentage of revenue should be between 22.7 percent
5 and 28 percent or between \$2.43 per sub and 3
6 dollars a sub, if you look at current market rates
7 and make appropriate adjustments. That's point
8 number 1.

9 To the extent that that's different than
10 what was put in place in SDARS I and SDARS II,
11 disentangling all that has changed in the market is
12 not something that I have sought to do. What I have
13 sought to do is to look at the current market rates
14 and to ask the question of whether -- what is --
15 what are the current market rates?

16 There's another question of whether, once
17 you've determined the market rates, would those
18 market rates impose such a big harm to Sirius XM
19 that there may be a decision not to engage in that
20 because it would significantly disrupt their ability
21 to compete or significantly disrupt their ability to
22 be viable?

23 On that last issue, I defer to Professor
24 Lys, because he has done the more detailed analysis
25 of that issue.

1 Q. Are you a Whole Foods shopper?

2 A. Sometimes.

3 Q. When you go to Whole Foods, do you
4 present your 1040 before they charge you for what
5 you buy?

6 A. If I'm not mistaken, Whole Foods doesn't
7 have a statutory regulation with regard to how
8 rates -- that they set my prices.

9 Q. Let's move on to ratio equivalency. You
10 predicate your ratio equivalence argument on the
11 proposition that there is a "sufficiently high"
12 cross-elasticity of demand between Sirius XM and
13 interactive services to validate -- to validate its
14 application here; is that correct?

15 A. That there's significant competition,
16 yes, sir.

17 Q. That was my next question. It means
18 there's significant competition between Sirius XM
19 and subscription interactive service, not just some
20 -- not just some degree of competition, correct?

21 A. That is correct.

22 Q. Okay. Yet, you've made no study of the
23 alternative channels people would most likely turn
24 to if they stopped using Sirius XM to get music,
25 have you?

1 A. I -- as I said yesterday, I have not done
2 that detailed econometric analysis, quantitative
3 analysis. Professor Willig has done that -- done
4 that analysis, as well as, obviously, there are
5 various other sources that I cite here, including
6 Sirius's own comments with regard to the degree of
7 competition between interactive services and itself.

8 Q. Yeah. We'll come to those. And you
9 haven't done any empirical analysis of the
10 cross-elasticity of demand between Sirius XM and the
11 interactive services; is that also correct?

12 A. That is correct. As I say, Professor
13 Willig presents not necessarily cross-elasticities
14 but diversion to interactive services.

15 Q. Nevertheless, in your view, there's a
16 sufficiently high cross-elasticity of demand between
17 Sirius XM and subscription interactive services to
18 warrant the application of ratio equivalency,
19 correct?

20 A. What I would say is similar competitive
21 conditions, yes, sir.

22 Q. All right. And in support of that, you
23 make four points, which appear in paragraphs 39-A
24 through D of your written direct testimony appearing
25 at pages 15 through 16. Could you confirm that,

1 please?

2 A. I don't believe this is the full extent
3 of those discussions, but this is part of those
4 discussions, yes, sir.

5 Q. Okay. Well, let's go through each of
6 those, if we may. In paragraph 39-A, you simply
7 point out that most "streaming" now takes place on
8 mobile phones, correct?

9 A. That is correct.

10 Q. That, by itself, doesn't demonstrate that
11 there's significant competition between Sirius XM
12 and subscription interactive services, does it?

13 A. That in and of itself does not, but it's
14 consistent with the increased convergence that --
15 that has been observed in the market by market
16 players.

17 Q. And in paragraph 39-B, you point out that
18 some listening on subscription Internet --
19 interactive services is to playlists, correct?

20 A. I don't like your characterization --
21 characterization of "some."

22 Q. Please.

23 A. It's more significant than "some." And
24 so consistent with that, the concept of lean-back
25 functionality is becoming increasingly important for

1 the interactive services.

2 Q. Okay. But that concept, by itself,
3 doesn't also demonstrate that there is significant
4 competition between Sirius XM and subscription
5 interactive services, does it?

6 A. In and of itself, it does not, but it is
7 directionally -- it's consistent with the increased
8 convergence.

9 Q. And in paragraph 39-C, you assert that
10 there is a "growing use of streaming services,
11 including interactive streaming services in the
12 car." Correct?

13 A. Consistent with the increased
14 convergence, yes, sir.

15 Q. And as support for that claim, you cite
16 to three documents; is that correct?

17 A. That is correct.

18 Q. I'd like to walk through each of those,
19 if we may. And the first is Trial Exhibit 123,
20 which is the Ipsos In-Car Audio Study. And that is
21 in binder 1, I believe.

22 JUDGE BARNETT: This is marked as
23 restricted, Mr. Rich.

24 MR. EBIN: Faster than me.

25 MR. RICH: I should note as to this

1 document, Your Honor, I'm advised that while it is
2 designated restricted, I believe the parties have
3 agreed that since you can readily find it on a web
4 site, it's inappropriately so designated.

5 JUDGE BARNETT: Okay.

6 MR. HANDZO: We agree.

7 JUDGE BARNETT: Thank you.

8 BY MR. RICH:

9 Q. Is this the study from which you provide
10 testimony in your written direct testimony?

11 A. It appears to be that, yes, sir.

12 Q. I believe the page that you reference is
13 titled Regular AM/FM Radio Still Dominates in-Car
14 Listening As the Top Platform Used?

15 A. That is correct.

16 Q. Am I correct? And I believe that is the
17 first page as you flip over from the title page; is
18 that correct?

19 A. Yes, sir.

20 Q. Okay. And this slide reports the
21 percentage of survey respondents that claim they
22 currently use the various listed services in their
23 car?

24 A. That is correct.

25 Q. Okay. So it doesn't give you a sense of

1 how much any of those listed services are used; is
2 that correct?

3 A. This is a yes-or-no question. Yes, sir.

4 Q. Yeah. It's just whether they're used at
5 all, right?

6 A. That is correct.

7 Q. Okay. And the only interactive service
8 listed here is Spotify, correct?

9 A. Spotify is listed. Some other streaming
10 audio service is listed. And as you know, iHeart
11 and Pandora, which are both listed, now currently
12 are offering fully interactive services.

13 Q. Do you know whether the Pandora and
14 iHeart responses here were responses to the
15 interactive offerings which are brand new or they
16 would have been responses preceding that point in
17 time?

18 A. Of course, they would have been preceding
19 that point in time, but, obviously, if I have the
20 Pandora service on my phone or in my car, it -- it's
21 just now a decision about the value of the Pandora
22 service, whether I want to switch, which option I
23 want to choose.

24 Q. And we're not asking you to testify here
25 as a consumer, sir. I'm asking you to talk about

1 what you sponsor here by way of your expert
2 testimony. On this chart, Spotify is listed as next
3 -- the next lowest response rate on this chart at
4 7 percent, correct?

5 A. That is correct. It's listed as
6 7 percent.

7 Q. So this slide -- and, by the way, in
8 reference to Spotify, this survey or at least the
9 depiction of the results doesn't distinguish between
10 Spotify's subscription service and its ad-supported
11 service, does it?

12 A. For all of the Services, it does not
13 distinguish between the ad-supported and the
14 subscription services.

15 Q. So this slide really doesn't tell us
16 anything about the extent to which consumers use
17 subscription interactive services in their cars,
18 does it?

19 A. That is correct. It provides information
20 about the use of streaming services in the car.

21 Q. Right. The next slide, which is on the
22 facing page, similarly touts the prominence of AM/FM
23 radio in the car, correct? It's titled More
24 Consumers Would Choose to Have a Regular AM/FM Car
25 Radio Over Any Other Audio Option, correct?

1 A. That is correct. So on the left-hand
2 side there, that's a free option. The CD player,
3 since they've already purchased the CD, would not
4 have any incremental subscription fee.

5 The MP3 option would be using digital
6 downloads. Satellite radio would be a subscription
7 option. And then the streaming would either be an
8 ad-supported or a streaming service option at
9 34 percent.

10 Q. And turning to the next slide in this --
11 in this survey, the question asked gets at which
12 services consumers would want in their next car if
13 cost was not an issue, correct? If you look down at
14 the bottom, it says disregarding any associated
15 cost.

16 Do you see that?

17 A. Yes, sir.

18 Q. Okay. And streaming Internet radio/
19 streaming music service appears as the second to
20 lowest reported category on that list, correct?

21 A. I'm just confused. Could you --

22 Q. 34 percent, correct?

23 A. Yeah, yeah. You said next slide. I'm
24 sorry.

25 Q. I'm sorry.

1 A. I misinterpreted that.

2 Q. Let me get you refocused. I apologize.

3 This is the slide that says more consumers would
4 choose to have a regular AM/FM?

5 A. Yeah, so this is what I just described,
6 that the -- the satellite radio and the streaming
7 options --

8 Q. Right.

9 A. -- are subscription-based services or
10 ad-supported.

11 Q. Correct. And so, again, for all we know,
12 that category could be dominated by ad-supported
13 streaming services and non-interactive streaming
14 services; we just don't know, correct?

15 A. This survey does not provide that level
16 of detail.

17 Q. Right. So this doesn't tell us anything
18 about whether consumers want to use subscription
19 Internet services or the degree to which they want
20 to use it in their cars, correct?

21 A. This, in and of itself, does not, no.

22 Q. Right. And it does make clear, however,
23 that AM/FM radio still dominates in the car, right?

24 A. That is correct.

25 Q. Okay. The next document you use, if we

1 could turn to Trial Exhibit 117 in your binder,
2 please, is an Edison Infinite Dial study from 2016;
3 is that correct?

4 A. Is that in the same binder?

5 Q. It should be forward a few documents in
6 that binder, 117.

7 A. Okay. I've got it, thank you.

8 Q. And do you recognize that as the study
9 from which you drew certain conclusions?

10 A. Yes, I do.

11 Q. Okay.

12 MR. RICH: And, Your Honors, once again,
13 same issue here, although listed restricted, we've
14 agreed that this can be admitted on a public record.
15 It is a publicly available document.

16 JUDGE BARNETT: Thank you.

17 MR. HANDZO: Agreed.

18 BY MR. RICH:

19 Q. Now, with respect to this survey, are you
20 aware that this same Edison is the entity with which
21 one of Sirius XM's upcoming trial witnesses is
22 associated, Mr. Lenski?

23 A. Sitting here today, I did not know that.

24 Q. Okay. I take it you view Edison as a
25 credible source for this kind of survey information?

1 A. Yes, sir.

2 Q. Okay. The slide from this presentation
3 that you point to is the one bearing a Bates stamp
4 SoundExchange 000034493, if you could work your way
5 to that, please. It's at page 16. I don't know
6 where the page number is, frankly -- no, sorry, that
7 was to your written direct testimony. I beg your
8 pardon. That's the only reference is to the Bates.
9 It's the one that says on-line radio listening in
10 car.

11 A. Yes, sir.

12 Q. Okay. That shows an increasing number of
13 people have ever listened to Internet radio in a car
14 by listening to the stream from a cell phone that
15 they have connected to a car audio system, correct?

16 A. Yes, sir.

17 Q. This slide addresses use of Internet
18 radio, correct?

19 A. That is correct.

20 Q. It doesn't speak specifically to
21 subscription interactive services, right?

22 A. That would be a part of Internet radio,
23 that is correct.

24 Q. And the final document you cite is a 2015
25 MusicWatch study that was prepared by the RIAA.

1 That appears at tab -- Trial Exhibit 122.

2 MR. RICH: And, Your Honors, while this
3 is a restricted document, I propose we don't put
4 anything about it up on any public screen, and I
5 will not elicit any data in it. I believe the level
6 of examination shouldn't be one that would intrude
7 on that. If my colleague across from me feels
8 differently, we can -- we can clear the courtroom
9 but, it's a very brief examination.

10 BY MR. RICH:

11 Q. Do you recognize this document?

12 A. Yes, sir.

13 MR. RICH: We would withdraw an earlier
14 objection, since this was part of my examination,
15 and offer this document into evidence.

16 MR. HANDZO: Since we apparently offered
17 it too, I have no objection.

18 JUDGE BARNETT: Exhibit 122 is admitted.

19 (SoundExchange Exhibit Number 122 was
20 marked and received into evidence.)

21 BY MR. RICH:

22 Q. Now, the slide you deal with in this
23 document is Bates numbered 00033362, if you could
24 turn to that, please.

25 A. Yes, sir.

CONFIDENTIAL SESSION 1210:4-5

1 Q. That slide claims that streaming is
2 rapidly growing as a percent of music time spent
3 listening in the car, correct?

4 [CONFIDENTIAL SESSION]

5

6 Q. And, again, the --

7 A. Sorry. I apologize for the numbers.

8 Q. Sorry. And this, again, is all about
9 streaming, correct?

10 A. Yes, sir.

11 Q. It says nothing specifically about the
12 use of subscription interactive services in the car,
13 does it?

14 A. That is correct.

15 Q. Now, you claim in your written direct
16 testimony in paragraph 39-C, that this slide
17 supports the assertion that time spent listening to
18 streaming has exceeded the time spent listening to
19 satellite radio. Is that a correct characterization
20 of your testimony?

21 A. Yes, sir.

22 Q. Let's take a closer look at what the
23 slide actually says. Do you see under the
24 subheading share of listening in the car, trended,
25 that there's a caveat that notes that these data are

1 limited to "streamers"?

2 JUDGE STRICKLER: Which document are you
3 looking at?

4 MR. RICH: So this, Your Honor, is --

5 JUDGE BARNETT: It's slide 72.

6 MR. RICH: This is Exhibit 122 at page
7 33362.

8 JUDGE STRICKLER: Right. I thought you
9 were reading some sort of a legend or disclaimer.

10 MR. RICH: Sorry. The --

11 JUDGE FEDER: It's highlighted --

12 BY MR. RICH:

13 Q. The share of listening in the car,
14 trended, and then beneath it, it says "among
15 streamers." Are you there? Do you see that?

16 A. Yes. So among those people who are using
17 some form of streaming, they -- they're turning to
18 streaming more than they turned to a satellite
19 option.

20 Q. Correct. So that's -- we're not talking
21 about a broader population, only a population of
22 streamers, correct?

23 A. In this calculation, yes.

24 Q. Yes. So -- so you don't note that caveat
25 in your testimony, do you?

1 A. I did not have that caveat. That is
2 correct.

3 Q. Now, we can put this binder away. If you
4 look at your written rebuttal testimony at page 24,
5 paragraph 53, you there contend that a given
6 performance on Sirius XM "may" have greater value
7 than a performance of music delivered by an Internet
8 -- interactive service, pardon me. Do you see that?

9 A. I don't -- the idea, I obviously recall
10 the precise sentence. Where in the paragraph is it?

11 Q. If you look at the last sentence of
12 paragraph 53, "thus each individual performance may
13 be relatively less valuable to the subscriber
14 compared to Sirius XM plays"?

15 A. Yes, this was a topic that came up
16 yesterday when I was here.

17 Q. Yes. And there are a lot of arguably's,
18 maybe's, et cetera's sprinkled throughout this,
19 correct?

20 A. I have not done the detailed analysis to
21 form a firm conclusion on this issue, but I discuss
22 the various interests and factors in this paragraph.

23 Q. And at least at your deposition, if I
24 may, it seemed that you're -- you were at least
25 somewhat influenced by your own activity as a

1 consumer; is that fair?

2 A. I gave an example for that moment. I
3 think we -- in response to a question from Judge
4 Strickler yesterday, we talked about how in the car
5 there's -- you're more captive. All consumers are
6 more captive.

7 And so the choice set that one has for
8 entertainment is more limited in the car, consistent
9 with what I wrote here.

10 Q. But as you've indicated, for our purposes
11 you've done no empirical examination of this issue,
12 correct?

13 A. I have not done -- tested that question
14 empirically. That is correct.

15 Q. Okay, thank you.

16 And you acknowledge that the rates to be
17 set in this proceeding, as we discussed, have to
18 reflect the workings of effective competition in the
19 target market, which is satellite radio, tempered by
20 whatever 801(b)(1) adjustments the Judges may
21 determine are appropriate, correct? I think we've
22 established that?

23 A. The idea is to determine rates based in
24 an effectively competitive market, considering the
25 factors, yes, sir.

1 Q. Right. And for your part, you believe no
2 801(b) adjustment -- adjustments are warranted on
3 the record as you see it, correct?

4 A. No additional adjustments beyond the ones
5 -- adjustments that I make to the market rates
6 between the benchmark and the target markets are
7 warranted. That is correct.

8 Q. Now, it's also the case, though, is it
9 not, that you, in proposing adoption of the
10 prevailing rates in the interactive service market,
11 it matters not to you whether, in fact, it is shown
12 that that market reflects the forces of competition?

13 A. No, what I'd say is that if that market
14 reflects the -- that it is increasingly effectively
15 competitive, then the adjustment between the
16 benchmark and the target market would be either zero
17 or less significant than the adjustment that would
18 be necessary if that market is not characterized by
19 the kinds of factors that are consistent with
20 effective competition.

21 Q. Well, let me just phrase it a little
22 differently. I don't think we're disagreeing. I
23 believe you would use this benchmark, irrespective
24 of what the Judges conclude as to the degree of
25 effective competition in that market, subject only

1 to whether and, if so, how large a steering
2 adjustment would be applied, correct?

3 A. It is my view that one could use this
4 benchmark with adjustments to take into account that
5 factor, so the answer to your question is yes.

6 Q. Yes. And so whereas in your written
7 direct testimony you suggest a modest steering
8 adjustment from those rates ought to suffice to
9 offset any supra competitive rate levels -- that's
10 at paragraphs 41 and 42 -- you've not made any
11 study, have you, of the extent to which monopoly
12 pricing in that market has driven prices above
13 competitive levels?

14 A. I have not done a -- and I'm not sure how
15 one would do that type of -- the study that you're
16 hypothesizing right now.

17 Q. And in that regard, the steering
18 adjustment you there propose, meaning in your
19 written direct testimony, is based on the discount
20 Sirius XM secured from its directly licensed labels
21 as compared to the payments it otherwise would make
22 under the statutory rate; is that correct?

23 A. Well, that's one. And as you know, in my
24 written rebuttal, I include alternatives as well.

25 Q. Stay with the direct for the moment.

1 We'll get there.

2 A. Right. As I said -- and I believe the
3 precise words were something to the effect of I'm
4 still studying this issue in my written direct
5 testimony, and I included an adjustment of up to
6 14 percent to take into account the potential
7 differences between the rates that could occur in a
8 market that would be effectively competitive with
9 one that -- ones that are not.

10 Q. But am I correct that in coming up with
11 that 14 percent, the measuring stick of it was your
12 determination or perhaps Professor Lys's or someone
13 else's determination of the maximum price benefits
14 Sirius XM received through its direct licenses from
15 the statutory license fee Sirius XM otherwise would
16 be paying?

17 A. Comparing the relative price -- if you
18 assume the entire discount was due to steering --

19 Q. Right.

20 A. -- then that discount would be -- would
21 reflect the difference between the competition or
22 the price that would prevail in the presence of
23 steering and the price that would not.

24 Q. Right. And so that steering adjustment
25 and that method of calculation has nothing to do

1 with an attempted adjustment from the rates paid in
2 the interactive services market to get to a
3 competitive rate, correct?

4 A. In my written direct testimony, and as
5 you know in my written rebuttal, I include
6 alternatives. And I've talked about those
7 alternatives in my testimony over the last day or
8 so.

9 Q. Now we're getting to that right now. So
10 in your written rebuttal testimony, and indeed in
11 slide 28, if we want to call it up, you propose
12 eliminating a steering adjustment altogether, don't
13 you?

14 A. Well, I start with the perspective, and I
15 think I've said this multiple times, so I don't want
16 to repeat myself, that there is not direct empirical
17 evidence in this case to warrant a -- an estimate,
18 but given the concerns and given that it does take
19 time for the market to change and given the options,
20 there is a range of a reasonable adjustment to --
21 that one could put forward, and I've talked about it
22 in the zero to 12, zero to 13 percent range.

23 Q. But the reasoning that undergirds your
24 view that no steering adjustment is warranted, what
25 you call the lack of an empirical basis, is that the

1 only appropriate time for such an adjustment to be
2 made or circumstance for it to be made is where it
3 is shown that the relative ability of the respective
4 services in the benchmark and target markets to
5 steer differ, correct? It's all about relativity to
6 you, right?

7 A. Relativity -- relativity is a key factor
8 in that discussion. So if the benchmark market is
9 effectively competitive and the target market is
10 similarly effectively competitive, then no
11 adjustment would be required in that circumstance.

12 Q. And, conversely, under your reasoning, if
13 neither market is effectively competitive, you would
14 likewise conclude no steering adjustment is
15 warranted, correct?

16 A. That -- now you enter -- you -- you go
17 from what would be a pure economic perspective of
18 using a benchmark and a target to now introducing
19 what would also involve the 801(b) factors. And in
20 such a circumstance, given that effective
21 competition is part of those factors, I think is a
22 fair reading of that framework, in that
23 circumstance, if both were not effectively
24 competitive, it would be consistent with those
25 factors to make an adjustment to effective

1 competition.

2 JUDGE STRICKLER: Are you saying that
3 adjustment for effective competition in that
4 situation would be done through the factors, rather
5 than in the ascertainment of the rate to be subject
6 to the factors?

7 THE WITNESS: From an economic
8 perspective, it's a distinction without a difference
9 because where you -- if you do it before or after in
10 some sense, it's not, in the end, that big of a
11 deal. What I would say is that the willing
12 buyer/willing seller framework should take into
13 account or will optimize those factors when in the
14 presence of effective competition.

15 And so if one is trying to use market
16 rates to meet those factors, one needs to ensure
17 that it has effective competition.

18 JUDGE STRICKLER: Assuming that the
19 benchmark and the target don't reveal effective
20 competition because there's no steering in either
21 one, which of the four factors would be applicable,
22 in your opinion, to -- to the -- to adjust the
23 rates, to present effective competition?

24 THE WITNESS: The way I -- I mean, these
25 factors overlap, obviously, because of the nature of

1 how they're described, but I would put it into the
2 second factor.

3 JUDGE STRICKLER: Fair return, fair
4 income?

5 THE WITNESS: Precisely.

6 JUDGE STRICKLER: Thank you.

7 MR. RICH: Do you have anything further,
8 Judge?

9 JUDGE STRICKLER: No, thank you. I'm
10 sorry.

11 BY MR. RICH:

12 Q. Turn to slide 34 of your deck, please.

13 I take it from your testimony yesterday
14 that this slide summarizes your views as to why it
15 is more appropriate to use effective rates from the
16 interactive service agreements than what you term
17 contract per-play rates; is that right?

18 A. That is correct.

19 Q. Now, in the first bullet there, you note
20 that there is "no economic rationale for using rates
21 that fail to reflect the underlying economics of a
22 transaction." Did I quote that correctly?

23 A. That is correct.

24 Q. I assume that proposition was as true two
25 years ago as it is today?

1 A. It's a general economic perspective. I
2 would -- I would add a caveat in the sense that no
3 economic rationale for using rates that fail to
4 reflect the underlying economics of a transaction,
5 if one has those underlying economics of the
6 transaction.

7 So you can imagine a situation -- and
8 just for clarity, I wanted to provide this caveat --
9 where a contract has been entered into, let's say,
10 but because of the newness of it, you don't have
11 actually good information about the effective --
12 what are the governing effective rates.

13 In that limited circumstance, I think
14 turning to what's in the contract would be a
15 legitimate and appropriate way to go because in that
16 case, you would not have effective rates to turn to.
17 But when one does have effective rates, there's no
18 sound economic rationale for avoiding those.

19 Q. And you understand that the Judges in the
20 Web IV determination modeled with respect to
21 subscription non-interactive services from contract
22 per-play rates, correct?

23 A. As I think I've said multiple times, I
24 was not exposed to the entire record. If I read the
25 decision as I cite in the fourth bullet to various

1 points, there is a use of the effective rates in
2 discussions of effective rates, and there's nothing
3 that I read in the decision suggesting that contract
4 rates were the appropriate way to go.

5 And so, quite to the contrary, if you
6 read the decision, there are places where it's
7 illuminated that the Judges were looking to the
8 effective rates, but I'm -- I defer to people who
9 are far more knowledgeable about their intent than
10 -- than my reading of it because I'm just reading it
11 -- who is somebody not exposed to the entire record.

12 Q. Assuming it were the case that the Judges
13 drew from the contract per-play rates rather than
14 the effective per-play rates, is it your view that
15 the methodology they would have used would have been
16 unsupported by any economic rationale?

17 A. Well, again, with the caveat I'm not sure
18 what was available as the options and the rationale
19 behind it, so to the extent that there was a sound
20 economic rationale, there wasn't data available, for
21 example.

22 And, obviously, the issues in Web IV are
23 slightly different than here, because you had both
24 an ad-supported market and a subscription market at
25 issue. And here you just have a subscription

1 market.

2 Q. Do you have a -- any understanding
3 whether the Judges actually considered those markets
4 and appropriate rates at separate points in their
5 decision-making?

6 A. Again, I'm just reading it. They come to
7 different rates. And there's extensive
8 discussion -- I have a short discussion of it in my
9 testimony -- about the difference between those who
10 didn't have a positive willingness to pay and those
11 who did and how these -- the rates that should
12 govern in those two circumstances should differ.

13 And so they do, I think it's fair to say,
14 differentiate between the ad-supported and the
15 subscription-based markets.

16 Q. In your third bullet on slide 34, you
17 note that "current marketplace evidence demonstrates
18 that per-play rates are not binding for interactive
19 subscription services and, thus, should not be used
20 to calculate a rate for Sirius XM."

21 Do you see that?

22 A. Yes, sir.

23 Q. Wasn't that also the case at the time of
24 Web IV, namely that the marketplace evidence
25 demonstrated that per-play rates were not binding

1 for interactive subscription services?

2 A. That's not an analysis that I've
3 conducted, so I don't have -- I can't give you an
4 answer to that.

5 MR. RICH: Your Honors, I don't know when
6 you want to break. This would be a convenient
7 moment if you'd like. We're moving to a different
8 section.

9 JUDGE BARNETT: That's a good breaking
10 point, then.

11 MR. RICH: I'm assuming I'll be about
12 another half an hour, perhaps.

13 JUDGE BARNETT: Thank you. We'll be at
14 recess for one hour.

15 (Whereupon, at 12:04 p.m., a lunch recess
16 was taken.)

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1 A F T E R N O O N S E S S I O N

2 (1:11 p.m.)

3 JUDGE BARNETT: Good afternoon. Please
4 be seated.

5 MR. HANDZO: If I may, I have a schedule
6 update since I raised it yesterday. I believe we
7 will have Dr. Ford following tomorrow after
8 Professor Lys, assuming we get that far, so I wanted
9 to alert the Court to that.

10 JUDGE BARNETT: Thank you. I also
11 noticed in our e-mail feed that there was an
12 unopposed motion to amend the Wazzan testimony,
13 direct and rebuttal; correct?

14 MR. HANDZO: That sounds right to me. I
15 think there were just a couple of typos that just
16 needed to be cleaned up. Nothing substantive about
17 it.

18 JUDGE BARNETT: Well, as it was
19 unopposed, I think that we can sign that order, so
20 you can assume it is granted.

21 MR. FAKLER: As long as -- since we're on
22 the record, it was far more than a couple of typos,
23 but it is unopposed.

24 JUDGE BARNETT: Thank you, Mr. Fakler.
25 Mr. Rich?

1 MR. RICH: Thank you.

2 BY MR. RICH:

3 Q. Afternoon.

4 A. Good afternoon to you.

5 Q. In proposing as your benchmark for
6 ratemaking here the prevailing rates in the upstream
7 market in which the major record labels license
8 interactive subscription services, you do so aware
9 not only that SoundExchange and prior economists
10 appearing on its behalf have used the same benchmark
11 in the Web IV proceeding, but also in the SDARS I
12 and II proceeding, true?

13 A. As a general matter, yes. Precisely what
14 was done, I'm not intimately familiar with.

15 Q. Yeah. And so while you opined that that
16 benchmark provided what you term in your written
17 rebuttal testimony at page 3 "a sound and reasonable
18 basis," for ratemaking in such past proceedings,
19 you, in fact, recall little of the specifics of the
20 SDARS II decision; is that accurate?

21 A. The precise nature of it, although I'm
22 aware that Professor Ordoover had used such a method
23 in SDARS II and Professor Rubinfeld used as a
24 benchmark the interactive services market in Web IV.
25 But how they implemented it, I do not recall.

1 At one point I looked at their testimony,
2 to the extent that I was able to, but I did not keep
3 track of the differences or the similarities beyond
4 the fact that they just used it as a benchmark.

5 Q. You are anticipating my outline nicely
6 here. So in addition to --

7 A. I have learned from some questions
8 earlier.

9 Q. In addition to what you have just
10 testified as to the recall as to Professor Ordovery's
11 work, you also have testified on deposition -- and
12 tell me if that's still your view -- that you don't
13 have a strong recollection as to how the Judges in
14 SDARS II analyzed the interactive benchmark?

15 A. I refreshed my recollection somewhat on
16 that -- on that question since we saw each other at
17 my last deposition and focused in on two of their
18 critiques of that benchmark.

19 Q. Which appear on your -- one of your
20 slides; is that right?

21 A. That is correct.

22 Q. Okay. We will get to there.

23 Now, while you were formulating your
24 written direct testimony, I take it, you did have
25 some discussions with Professor Ordovery and at some

1 point reviewed his prior testimony; is that correct?

2 A. I wouldn't agree with that. I had a
3 discussion with Professor Ordoover when I had first
4 received the call from counsel from SoundExchange.
5 By the time I got around to preparing my written
6 direct testimony, I was not -- I had a conversation
7 right at the beginning, but it was many months later
8 when I started writing my written direct testimony.

9 Q. Now, the fact is you and he shared a
10 colleague at your consulting firm in preparing your
11 respective testimonies; his in satellite II and
12 yours here, correct?

13 A. One staff member, yes, that is correct.

14 Q. Whose name is Doug Fontaine?

15 A. That is correct.

16 Q. And he is not just a staff member, I take
17 it he is a reasonably senior staff member, correct?

18 A. That is correct.

19 Q. Now --

20 JUDGE STRICKLER: Before you go on,
21 counsel had pointed you to page 3 of your written
22 direct testimony. I am taking a look at paragraph
23 9. Do you see that?

24 THE WITNESS: Yes, sir.

25 JUDGE STRICKLER: In the middle of the

1 paragraph you write, "I conclude that interactive
2 subscription services represent the most reasonable
3 and appropriate benchmark," and I will leave off the
4 rest of the sentence there.

5 Did you go through other -- before you
6 saw whatever it was that the Sirius XM was proposing
7 or anything else that any of the other experts were
8 going to do in this case, did you go through other
9 potential benchmarks and disqualify them as inferior
10 to the interactive benchmark?

11 THE WITNESS: Yes, sir, I did.

12 JUDGE STRICKLER: Which ones did you go
13 through?

14 THE WITNESS: So I started broadly, and
15 asked, you know, could you -- could you look to is
16 there any information in digital downloads, is there
17 anything that we can observe in, say, the video
18 world? Is there something I can glean in -- to the
19 extent that there is any information in the -- what
20 we will call the mid-tier segment, and so I
21 considered option -- other options. And there may
22 have been a couple of others that I had considered.

23 Whether there was information and asked
24 questions, and then zeroed in on the interactive
25 services benchmark because for the precise reason,

1 it is the most reasonable and appropriate to turn
2 to, making the necessary adjustments, as I believe I
3 have proposed.

4 JUDGE STRICKLER: So you -- so,
5 therefore, you describe it as I just read, as "the
6 most reasonable and appropriate benchmark."

7 THE WITNESS: That is correct.

8 JUDGE STRICKLER: Okay. Was it better
9 than the bad benchmarks? Did you find it a good
10 benchmark or just to paraphrase from the movie
11 "Argo," was it the best bad plan you had?

12 THE WITNESS: Or the Winston Churchill
13 quote about democracy.

14 JUDGE STRICKLER: Something like that.

15 THE WITNESS: No, I think it is a good
16 benchmark. What you are looking for in a benchmark,
17 if you are looking in intellectual property cases or
18 in valuation matters is something that is comparable
19 to the target that you're trying to value, and then
20 you want a benchmark where you can make adjustments
21 to account for any differences.

22 And this benchmark meets all those
23 conditions.

24 JUDGE STRICKLER: So it was a good
25 benchmark --

1 THE WITNESS: It is a good benchmark.

2 JUDGE STRICKLER: -- subject to the
3 adjustments you made.

4 THE WITNESS: In absolute terms. And it
5 is the most reasonable and appropriate in relative
6 terms as well.

7 JUDGE STRICKLER: Thank you.

8 BY MR. RICH:

9 Q. Now, you maintain that you are unaware of
10 the degree of similarity between the two approaches
11 to rate setting you propose here and those proposed
12 by Professor Ordover in SDARS II; is that correct?

13 A. That is correct.

14 Q. So much so that even after being
15 questioned at your first day of deposition in
16 January of this year about that, you failed to go
17 back either to the SDARS II decision or to Dr.
18 Ordover's testimony to ascertain the degree to which
19 that's the case, correct?

20 A. That's correct. I didn't think it was
21 relevant for my analysis.

22 Q. And in your Approach 1, you simply take
23 the effective percentage-of-revenue rate paid by the
24 subscription interactive services and cut it in
25 half, right? If you want we can reference your

1 slide 22 from yesterday.

2 A. That's -- you have oversimplified it but
3 the 50 percent is based on an estimate of my
4 analysis of the music share of the overall value of
5 Sirius XM revenue.

6 And as I noted yesterday, there is
7 current information from Mr. Boedeker's survey that
8 would suggest that that is a conservative
9 assumption. It could be even higher than that.

10 Q. Just -- just take a look, and I will
11 invite the Judges to take a look at slide 22 in your
12 deck from yesterday, just to confirm that that's the
13 math that generates the result under your Approach
14 1?

15 A. That is correct.

16 Q. Namely, taking the
17 benchmark percent-of-revenue rate which is set forth
18 there, and adjusting it for non-music content,
19 simply multiplying the two and coming up with what
20 here is 28 percent; is that correct?

21 A. Prior to any adjustments at which the
22 slides beyond that go into, yes.

23 Q. Yes. Now, in your first binder -- wrong.
24 In your second binder, binder number 2
25 there is the SDARS II decision behind the tab. And

1 if you would find that. If you could turn, please,
2 at the top corners is pagination, and the page I
3 want you to turn to is 20362.

4 And if you will direct your attention to
5 the bottom right-hand column, continuing over on to
6 the next page, it reads, "examining the agreements,
7 he" -- meaning Professor Ordoover -- "determined that
8 the annual payments as a percentage of gross
9 subscription revenues of the services ranged from 50
10 to 70 percent, and tended to cluster in a range of
11 60 to 65 percent.

12 "Dr. Ordoover then attempted to account
13 for the fact that the Sirius XM satellite radio
14 service, unlike interactive subscription services,
15 transmits both music and non-music content by
16 reducing the percentage-of-revenue rate from the
17 interactive subscription agreements in half."

18 Do you see that?

19 A. Yes, sir.

20 Q. That's exactly what you do here in your
21 Approach 1; is that correct?

22 A. That is correct, but it wouldn't surprise
23 me if, as you described earlier in the question,
24 there hadn't been a significant change in the
25 relative contributions of music and non-music

1 content to the Sirius XM service, and so it looks
2 like he used half.

3 I do use half, although I know that
4 that's conservative. I don't know what Professor
5 Ordoover has done.

6 Q. Forgetting for a moment the numbers that
7 are plugged in, the methodology and the math
8 process, the steps to get there are identical,
9 correct?

10 A. With regard to this issue, obviously I'm
11 using 56 percent; he is using 60 to 65 percent. So
12 the math is different, but he does use half. I have
13 no idea what other adjustments he makes beyond that
14 with which is right here.

15 Q. But if Professor Ordoover were sitting
16 here, he might well have reproduced your slide 22
17 and just plugged in the appropriate numbers saying
18 this was his, what he termed primary approach to
19 ratemaking, correct, so it appears to you?

20 A. I have no idea what he did in terms of
21 whether he stopped there or he considered any of the
22 other eight or ten adjustments that I considered and
23 made some and did not make others.

24 Q. And as you point out, he used slightly
25 higher percentages so that his rates came out

1 between 30 -- I will represent to you -- between 30
2 and 32 and a half percent, where as yours come out
3 under Approach 1 at 28 percent.

4 And I was about to suggest that wouldn't
5 that be explained by basically the fact that the
6 effective percentage-of-revenue rate paid by
7 interactive services has declined slightly between
8 SDARS II and today? Would you agree with that?

9 A. With the caveat that I'm not sure
10 precisely how Professor Ordoover calculated his 60 to
11 65 percent, but if he did it very similarly, it
12 would suggest they declined from somewhere in the 60
13 to 65 percent range, to 56 percent.

14 Q. Now, separate and apart from the degree
15 of familiarity you have with Professor Ordoover's
16 methodology, you were aware at the time you prepared
17 your written direct testimony that the Judges in
18 evaluating Professor Ordoover's primary approach did
19 "not find that the market for interactive
20 subscription services as characterized by Dr.
21 Ordoover in this proceeding offers a foundation to
22 support a comparable benchmark from which to begin
23 an analysis of reasonable rates for SDARS for the
24 coming -- for the upcoming license period."

25 You do recall reading that prior to

1 preparing your testimony, correct?

2 A. Or some language like that, yes, sir.

3 Q. You also were aware, were you not, that
4 the Judges concluded in SDARS II that "the rights
5 licensed by interactive subscription services are
6 not the same as those by non-interactive services
7 such as the SDARS and the Judges did not find Dr.
8 Ordover's efforts to adjust for the differences to
9 be helpful." Do you remember reading that as well?

10 A. Language to that effect, the precise
11 language I did not commit to memory, but that
12 general theme, yes.

13 Q. And I take it that you were also aware
14 that the Judges in SDARS II concluded that Professor
15 Ordover's primary approach yielded rates that are
16 "so much higher than the current statutory rate that
17 they are outside the zone of reasonableness"?

18 A. I remember that language, yes, sir.

19 Q. And none of those -- none of those
20 cautions deterred you from pursuing the identical
21 modeling here, correct?

22 A. I can't agree that it is identical
23 modeling because I'm not aware of, and any
24 discussion in the SDARS II decision, for example,
25 Professor Ordover considering the issues, such as

1 the Indie versus Major issue that I talked about
2 earlier, considering a steering adjustment,
3 considering the other factors that I have described,
4 on the one hand, and then the other hand is
5 obviously the interactive market was in a different
6 state in the time frame at the time that SDARS II
7 was decided or Professor Ordoover was presenting his
8 analysis, such that as I think I described earlier,
9 we know that Apple, which is a very big player, and
10 Spotify had either -- for Apple, entered the market
11 in 2015 and for Spotify it either entered the market
12 sometime in I think late '10 or early '11, and
13 whether that information was available to Professor
14 Ordoover, I don't know the precise date of his work.

15 Q. So if you turn to your slides 37, which
16 you discussed yesterday, which is labeled Sirius XM
17 critique, interactive benchmark rejected in SDARS
18 II, you then have a series of what are labeled
19 responses, correct?

20 A. That is correct.

21 Q. Now, I don't see anywhere in these
22 responses, though, any reflection of any of the
23 analysis engaged in by the Court that I read to you
24 and that you indicated you were aware of. That's
25 not on this sheet, is it, anywhere?

1 A. Well, they are consistent. I mean, I'm
2 trying to summarize obviously in a short slide a
3 relatively lengthy decision, but one of the -- I'm
4 saying they rejected the interactive market in part
5 as a benchmark and in part or in full because of the
6 current state of that market at that time that
7 Professor Ordoover presented it, although I should
8 note just for the record, as I noted on the slide,
9 that it had been utilized in SDARS I and was
10 utilized in Web IV.

11 Q. But, for example, there is nothing on
12 slide 37 that reflects the fact that the Judges
13 found the rates so much higher than the then
14 existing current statutory rate as to fall outside
15 the zone of reasonableness? You don't address that
16 on this slide, correct?

17 A. That is correct, but obviously that is
18 dependent upon the underlying analysis, which was
19 predicated on the benchmark not being a sound
20 benchmark and that there was not a comparison to the
21 Indies.

22 Q. In your Approach 2, you take the
23 effective per-subscriber payment paid by
24 subscription interactive services to the major
25 labels as your starting point; is that correct?

1 And, again, we can reference for the Judges' benefit
2 here your slide 26.

3 A. Yes, sir.

4 Q. And you then adjust that by the ratio of
5 the retail price of what you describe as
6 subscription non-interactive services by the retail
7 price for subscription interactive services,
8 correct?

9 A. That is correct.

10 Q. And as you discussed yesterday, the
11 non-interactive services that you used for these
12 purposes are Pandora One, Rhapsody unRadio, and
13 Slacker Radio? That's on your slide 25?

14 A. That is correct.

15 Q. Now, all three of these products offer
16 greater customization than does Sirius XM; is that
17 true?

18 A. At that time there would be a slight
19 difference in the sense of there was hourly and
20 daily limits, for example, on Pandora One. And
21 Pandora One, given I am doing a weighted average, is
22 the one we should focus on.

23 And my understanding is that they -- that
24 someone subscribing to Pandora One would have the
25 ability to skip -- not rewind, but just skip -- a

1 limited number of times per hour and per day.

2 Q. It is also the case, though, with respect
3 to Rhapsody unRadio and Slacker, they offered
4 functionality that goes beyond that allowed under
5 the 114 license, correct?

6 A. That is correct. But in terms of the
7 contribution to the analysis given that Pandora is
8 almost 90 percent of the share, there consumer price
9 is driving in essence this analysis.

10 Q. But for purposes of the analysis you
11 undertook here in your Approach 2, you didn't
12 attempt to make any adjustment to the retail price
13 comparators to account for the fact of this
14 differing functionality, correct?

15 A. That is correct. I did not make an
16 additional adjustment for the ability for a consumer
17 to skip that's available on, say, Pandora One, but
18 is not available on Sirius XM. I talked earlier
19 today in response to a question from you about how
20 one could further adjust this interactivity
21 adjustment to take into account the changes that
22 have occurred in the new deal.

23 And it would lower this percentage from
24 .49 to something slightly below .49.

25 Q. So turning back to your approach and back

1 to slide 26, you take the ratio of these two sets of
2 retail prices, which you have identified as .49, and
3 multiply that by the effective per-subscriber
4 royalty paid by subscription interactive services to
5 the major labels, correct?

6 A. Yes.

7 Q. And this approach, I think as Mr. Handzo
8 also indicated yesterday, is mathematically
9 equivalent to taking the 56 percent of revenue used
10 in your Approach 1 and multiplying it by the average
11 retail price of the Services that you characterize
12 as non-interactive, correct?

13 A. It will be -- the ARPU or the weighted
14 average, it should work out to the same amount.

15 Q. So at bottom the only difference between
16 your Approaches 1 and 2 is the retail price that you
17 apply to that 56 percent of revenue, correct?

18 A. That is in some sense correct, but there
19 is obviously information in the retail price that
20 consumers are paying for that product.

21 Q. Understand. But in Approach 1, you apply
22 that 56 percent against half of the Sirius XM ARPU
23 price, ARPU, correct?

24 A. That is correct.

25 Q. And in Approach 2 you apply it against

1 the retail price for the non-interactive services
2 that you selected, correct?

3 A. That is correct. And it comes out
4 roughly the same because of the consistency in the
5 marketplace between the percentage-of-revenue that
6 is paid by the interactive services and, in essence,
7 the ratio of the retail prices.

8 Q. Now, your Approach 2 is also identical to
9 an approach used by Professor Ordoover in SDARS II,
10 isn't it?

11 A. With the same -- I am not precisely what
12 Professor Ordoover did, I'm not -- sitting here I do
13 not know.

14 Q. Well, you did indicate at your deposition
15 that at some point you read his deposition
16 testimony, is that correct?

17 A. That is correct. But I didn't commit to
18 memory -- when you showed me SDARS II, it -- he --
19 he appears to show, do a couple different approaches
20 as they describe. So what else he did, I do not
21 know.

22 Q. That's fine. Let's call up on the
23 screen, and I will ask you in the same binder, sir,
24 the last tab, I believe, is a copy of Mr. Ordoover's
25 written direct testimony in Satellite II?

1 MR. HANDZO: I am not going to object. I
2 am not aware that Professor Ordovery's testimony in
3 SDARS II has ever been listed by Sirius XM as an
4 exhibit in this case. We have a process both to
5 list exhibits and to specifically call out which
6 ones may be used with a witness, and I don't believe
7 it has been listed at any time.

8 MR. RICH: This is being used for
9 impeachment, Your Honor.

10 MR. HANDZO: There is no statement that
11 contradicts anything in Professor Ordovery's
12 testimony that could reasonably be called
13 impeachment.

14 MR. RICH: I haven't asked the questions
15 yet.

16 MR. HANDZO: I think you need to ask the
17 question before you impeach the answer.

18 JUDGE BARNETT: That is true, Mr. Handzo.
19 So if you have a question that you are trying to
20 impeach with, what is the question?

21 MR. RICH: My question is I was going to
22 address -- I was going to point the witness to a
23 specific paragraph in this which confirms, in fact,
24 and consistent with a prior reading by the witness
25 of this testimony that Mr. Orszag's Approach 2 is,

1 in fact, identical to the approach that Professor
2 Ordoover had taken and which the Court had given
3 consideration to.

4 MR. HANDZO: That's not impeachment. And
5 Mr. Rich is trying to use a document which he has
6 never listed as an exhibit.

7 JUDGE BARNETT: Specifically what
8 statement of this witness?

9 MR. RICH: Pardon me?

10 JUDGE BARNETT: What is the specific
11 statement of this witness that you are --

12 MR. RICH: I think the witness is trying
13 to convey that he and his team invented out of whole
14 cloth a methodology without any reference to prior
15 jurisprudential guidance, without prior work by
16 prior economists here. And it is -- it, frankly,
17 betrays any realm of coincidence that his two
18 approaches are identical to those approaches taken
19 by Professor Ordoover. That's all.

20 JUDGE BARNETT: Do you have a question?

21 JUDGE STRICKLER: Yeah, I thought maybe
22 we can repeat this question and answer. Wasn't
23 there a question posed to the witness as to whether
24 what you did was identical to Professor Ordoover?

25 MR. RICH: Yes.

1 JUDGE STRICKLER: And the answer I
2 thought was no, it is not identical. And what I
3 thought you were about to do was say: Here is what
4 he did, isn't this identical?

5 MR. RICH: Precisely.

6 JUDGE STRICKLER: Well, is there anything
7 more to this than that?

8 MR. RICH: No.

9 THE WITNESS: If I may for one second,
10 sir, I didn't say no, it is not identical. I don't
11 know what Professor Ordoover did precisely, so I
12 can't give an answer one way or the other because
13 what he did and what I did, I have not matched up.

14 And I have read Professor Ordoover's
15 testimony a year plus ago, and I haven't looked at
16 it since. So what he did I am not sure about.

17 JUDGE BARNETT: So I don't think you can
18 impeach an "I don't know" answer, Mr. Rich.

19 MR. RICH: Okay. We will move on.

20 JUDGE BARNETT: Sustained, Mr. Handzo.

21 BY MR. RICH:

22 Q. A few questions about your testimony
23 concerning payments for free trials.

24 A. Sure.

25 Q. You say there is -- and this is written

1 direct testimony, paragraph 85. You say there is,
2 "no sound basis for disparate treatment" of Sirius
3 XM trials and interactive service trials. Is that
4 correct?

5 A. That is correct.

6 Q. Have you provided any basis for the same
7 treatment?

8 A. Well, all the same -- the same underlying
9 analyses that show the similarities and
10 comparabilities between the markets and the fact
11 that there is -- in the same analyses that show the
12 relative comparability for the purposes of
13 substitution and promotion, et cetera, that I talk
14 about in here and Professor Ford and/or Dr. Ford and
15 Professor Willig will talk about more, are
16 consistent with using the interactive services as a
17 benchmark for considering the free trial issue.

18 Q. Have you done any examination of the
19 interactive trial subscription experience or process
20 as compared to Sirius XM's trial subscription
21 process?

22 A. To the extent that -- the answer is yes,
23 because I have looked at the current rules with
24 regard to trials with regard to interactive
25 services. And those are presented on the previous

1 page in slide -- I mean, Table 4.

2 And I have also examined the issue of
3 trials with regard to Sirius XM, both here and then
4 also in my written rebuttal testimony.

5 Q. And what have you learned specifically
6 with respect to the respective conversion rates for
7 interactive trial subscribers versus Sirius XM trial
8 subscribers?

9 A. The relative conversion rates is not an
10 analysis that I have conducted. I'm not aware of
11 the interactive services making such information
12 publicly available.

13 Q. What examination have you made of Sirius
14 XM's access to trial subscriber contact or credit
15 card information and when it is first obtained?

16 A. Not to use an anecdote, but as a Sirius
17 XM subscriber, I actually just got an e-mail asking
18 for my credit card information after having gone
19 through a free trial. So Sirius XM, unlike some of
20 the interactive services, does not appear to require
21 a credit card in the process; whereas an interactive
22 service, the term of the free trial in terms of its
23 relationship with the labels depends in part in some
24 cases on whether the individual gives a credit card
25 or not.

1 For example, if an individual gives a
2 credit card with, I believe it is Spotify, the free
3 trial period is one month. And if you do not give a
4 credit card, I believe it is 14 days.

5 Q. Is the entirety of your knowledge about
6 Sirius XM's access to contacting credit card
7 information as a consumer?

8 A. No, it was a cite to an actual document,
9 I believe, in my report about the credit card issue.

10 Q. What examination have you made of Sirius
11 XM's access to e-mail addresses for subscribers and
12 when they are obtained?

13 A. I have not examined that narrow issue.

14 JUDGE STRICKLER: Excuse me. When you
15 looked at trial subscriptions, both for interactive
16 streaming and Sirius XM, did you see whether there
17 were different opt-in or opt-out provisions for
18 those who were trial subscribers?

19 That is to say, after the trial period
20 ended, did subscribers have to affirmatively opt-in
21 to continue and pay or did they have to
22 affirmatively opt-out to avoid paying?

23 THE WITNESS: It is a great question. I
24 did not examine that issue because in the way that
25 I'm proposing to do my -- the free trial, what

1 matters is what -- there is a three-part question.

2 How should we pay that proposed
3 per-subscriber for the reasons I described
4 yesterday, so I won't repeat that.

5 When should they start paying? So that
6 -- the opt-in versus opt-out is a fascinating
7 question. But it doesn't go to the question of when
8 should they start paying. And then the question is
9 at what rate.

10 And I'm using the conversion rate within
11 Sirius, and that 40 percent of people convert and 60
12 don't. And I am using that information only for
13 Sirius. I haven't compared that 40 percent
14 conversion rate to what an interactive service does.
15 And I haven't compared, thus, what could explain
16 those differences in terms of opting in or out.

17 But it is a really fascinating question
18 to potentially examine, but I don't think it goes to
19 the heart of what the appropriate rate should be for
20 Sirius here.

21 JUDGE STRICKLER: Thank you.

22 BY MR. RICH:

23 Q. Many interactive services have a free
24 tier; is that right?

25 A. That is correct.

1 Q. So after 30 days on Spotify, for example,
2 a subscriber can continue using Spotify's free tier;
3 is that right?

4 A. That is correct.

5 Q. For months or even years?

6 A. That is correct.

7 Q. So the free trial doesn't really end
8 after 30 days, correct?

9 A. Well, you have a service that is
10 different than the service that you receive if you
11 pay for the subscription because you have to view
12 ads or listen to ads, depending upon which service
13 it is.

14 Q. Spotify's payments to the labels for the
15 free tier are a small fraction of its payments for
16 the subscription tier, correct?

17 A. In total, it would -- it would be a small
18 fraction because they are -- the number of people
19 who are falling into the trial subscriber category,
20 just as under my proposal, the vast majority of the
21 Sirius XM subscribers would be paying full freight
22 instead of paying under the trial subscribers as
23 well.

24 Q. But, in any event, the Spotify Free
25 trialers can convert to being a paying subscriber

1 from the free tier well after the 30-day period,
2 correct?

3 A. That is correct, but they are obviously
4 paying full royalties whenever the trial ends.

5 Q. Pardon me. I didn't mean to interrupt.

6 A. I was going to say, yes, but obviously
7 they are -- depending upon the agreement, that
8 Spotify can only provide a free trial for a period
9 of time. And after that time it pays the royalty
10 rate under the contract.

11 Q. But with Sirius XM, by comparison, at the
12 end of free trials, the radio is turned off,
13 correct? There is no free tier?

14 A. That is correct. There is not a free
15 tier on Sirius.

16 Q. Now, in your written direct testimony at
17 paragraph 90, you suggest that Sirius XM would have
18 an incentive to shift to unpaid trials to avoid
19 paying Sirius XM royalties, a suggestion you called
20 "gamesmanship."

21 Do you recall that testimony?

22 A. Yes, sir.

23 Q. What evidence do you have that Sirius
24 XM's use of unpaid trials has been motivated by a
25 desire to avoid paying SoundExchange royalties?

1 A. I'm just talking about the economic
2 incentive that would be present to shift when one is
3 not -- there is no royalty associated with one and a
4 royalty payment associated with the other approach.

5 And so given that incentives, it provides
6 incentives for them to move from paid trials to
7 unpaid trials, holding all else constant. And
8 consistent with that incentive, we have seen a shift
9 from -- and this is presented in Table 5 and then in
10 a footnote, as well in this report -- a shift from
11 paid trials to unpaid trials.

12 I am not saying that they have engaged in
13 gamesmanship. I am saying that there is an
14 incentive to move in that direction. And what one
15 would want to do is to ensure that the system of
16 payment is consistent with being neutral between
17 those options, so that there is not a distortion in
18 the marketplace.

19 Q. So you are not neutral in attempting
20 slyly to create an implicit causation there, are
21 you; that is, namely, that the potentially
22 independent events of legitimate business reasons
23 for moving to more free trials may be well
24 completely associated with reasons having nothing to
25 do with gamesmanship? You just don't know, you are

1 speculating, aren't you?

2 A. That the economic incentive is in place,
3 and so the better idea is to ensure that the trials
4 are neutral with regard to those issues from an
5 economic perspective, and so that there is not the
6 incentive in place to ensure that that happens.

7 Q. So speaking of economics, can you think
8 of any reason that Sirius XM would forego 89 cents
9 on the dollar to avoid paying 11 cents to
10 SoundExchange?

11 A. Because it is not just that simple.
12 Because in the context of the paid trials, there is
13 both costs that are incurred and revenues that are
14 received. And if you have the incentive that under
15 one you are paying 11 cents and under the other you
16 can pay zero, you may say: Okay, what I'll do is
17 reduce the revenue piece and accept more of the
18 costs associated with those paid trials. That's the
19 incentive that I'm concerned about.

20 And so it is much better to say from an
21 economic perspective that there is a single royalty
22 paid for unpaid and paid trialers. And whatever
23 revenue Sirius can collect on that -- on those, for
24 those trials is theirs to keep. That would be a
25 non-distorting system for trials.

1 And that's why -- the issue that's at
2 here, is that if it were just revenue, I would
3 agree, but there is also the cost items in these
4 agreements. And that has to be considered as well.

5 Q. You are right in saying it is not so
6 simple. Might you agree that it could just be that
7 Sirius XM has determined in its business judgment
8 that it is worth the short-term revenue hit to
9 entice a customer to subscribe and pay for a
10 multi-year period?

11 A. All trials by definition have that
12 incentive. The point is right now there is a
13 difference between paid and unpaid. And so to
14 harmonize the incentives there ensures that we have
15 an efficient outcome from the perspective of
16 consumers and from the perspective of the
17 participants in this negotiation, in some sense this
18 outcome, the label and the service.

19 And we have that circumstance when you
20 look at the interactive market that there is a
21 commonality of interest, but right now there is not
22 a commonality of interest between paid trials and
23 unpaid trials. And that's the issue that concerns
24 me from an economic incentives perspective. And so
25 harmonizing that makes economic sense.

1 Q. You don't sitting here today profess to
2 have a full picture of all of the business
3 rationales that drive Sirius XM's free trial
4 programs, right?

5 A. I defer to the businesspeople about all
6 their business rationales. What I can focus on is
7 the economic incentives created by the current
8 structure where there is a royalty paid in one
9 circumstance and not in the other.

10 Q. Now, in your written rebuttal testimony
11 you propose that the payment for free trial
12 subscribers be cut approximately in half; is that
13 right?

14 A. That is correct.

15 Q. Are you aware that's not a part of any
16 SoundExchange fee proposal in this case, rate
17 proposal?

18 A. Sitting here today, what is their
19 proposal versus my analysis, I do not know one way
20 or the other.

21 Q. Now, referencing your written rebuttal
22 testimony in paragraph 60, if you want to take a
23 look at that. What evidence do you have that it is
24 possible for Sirius XM to just "increase its
25 conversion rates"?

1 A. Am I missing this? In paragraph 60? I
2 don't see a mention of --

3 MR. HANDZO: I am not sure you have the
4 right paragraph.

5 MR. RICH: Sorry.

6 MR. EBIN: 64.

7 MR. RICH: Thank you.

8 BY MR. RICH:

9 Q. Are you there now?

10 A. Yes.

11 Q. Do you have the question?

12 A. Not precisely. Would you mind repeating
13 it?

14 Q. So you suggest that a simple solution
15 here would be for Sirius XM just to increase its
16 conversion rates. What information and knowledge do
17 you have about the ease or difficulty Sirius XM
18 would have in simply increasing its conversion
19 rates?

20 A. That's not exactly what I propose. So
21 what I -- I say is that confronted with a new
22 structure where free trials are paying a royalty
23 consistent with the interactive services benchmark,
24 they would be free to make a profit-maximizing
25 decision to redesign their free trial program to

1 optimize in this new, more efficient structure.

2 And so they may choose to collect credit
3 card information or they may choose to shorten the
4 period or they may say, you know what, even with the
5 current structure, what we have now is optimal. It
6 would be their decision then to make a
7 profit-maximizing decision consistent with their
8 incentives when you have a more efficient royalty
9 structure.

10 Q. So Sirius XM by your likes should put the
11 SoundExchange payment cart ahead of the business
12 horse and potentially turn its business upside down
13 to make sure that SoundExchange gets paid on free
14 trials after 30 days?

15 A. No. I mean, the idea here is that
16 artists, when -- if Sirius XM believes that what is
17 good for Sirius XM is good for the artist, the
18 artist and the labels as evidenced by the fact that
19 the trials in the interactive market tend to be on
20 the order of magnitude of one month, where the
21 trials for Sirius XM tend to be longer, are losing
22 revenue that they otherwise would have received
23 given the substitution patterns.

24 And so they have an interest in ensuring
25 that they are fairly compensated. And so it is

1 consistent with the factors, it is consistent with
2 the benchmark that the royalty would be set up in
3 that structure. And then given that structure, they
4 would then optimize the system to use.

5 Q. Let's change subjects. You are aware
6 that Sirius XM, in addition to offering a satellite
7 radio service, also offers a subscription webcasting
8 service, correct?

9 A. That is correct.

10 Q. And that service pays pursuant to the
11 statutory license covering non-interactive
12 webcasters, correct?

13 A. I believe that to be true, yes.

14 Q. And I will represent to you that they are
15 paying at the rate set in the Web IV proceeding,
16 okay?

17 A. Sure.

18 Q. Now, Sirius XM's webcasting service is
19 quite similar to Sirius XM's satellite service,
20 correct?

21 A. I haven't studied in detail, but I
22 believe there is a lot of similarities.

23 Q. And if anything it offers slightly more
24 functionality than offered on the satellite service,
25 true?

1 A. It offers, in the sense that you can
2 skip, yes.

3 Q. Okay. So Sirius XM currently pays .22
4 cents for each performance on its subscription
5 webcasting service that you understand, right?

6 A. That is correct.

7 Q. And so if we, by way of example, took a
8 subscriber who listens to 469 performances a
9 month -- just to pick a random number -- I will
10 represent to you that the math times .22 cents would
11 be \$1.03 per month per-subscriber. Okay? Would
12 that be correct mathematically?

13 A. Given that those are similar numbers to
14 those presented by Professor Shapiro, yes.

15 Q. Okay. And that \$1.03 per month under
16 that assumption would be true if a subscriber to
17 Sirius XM's webcasting service listened to these
18 performances through its Smartphone in the car,
19 correct?

20 A. That is correct.

21 Q. Now, in your view Sirius XM should pay
22 SoundExchange rates approaching 3 dollars for each
23 of its satellite subscribers, including for those
24 who listen to, let's say, 469 performances a month,
25 correct?

1 A. That is correct.

2 Q. Or nearly three times as much as it pays
3 for a subscriber that listens to the same content in
4 the same quantity but does so on the webcasting
5 service, correct?

6 A. Just to be precise, I give a range. You
7 picked the highest end of the range. I used \$2.43
8 to 3 dollars as my reasonable range.

9 Q. But a large -- a largely different sum,
10 correct?

11 A. That is correct.

12 Q. With respect to direct licenses, with
13 respect to direct licenses, is it your view that
14 Sirius XM's direct licenses were negotiated under
15 workably competitive conditions?

16 A. Well, here is the -- the market involving
17 Sirius XM has characteristics consistent with
18 workable competition. The negotiation does not
19 approximate a pure willing buyer/willing seller
20 framework, given that it -- the fall-back option,
21 the walk-away option is not a -- is not having
22 access to the service, but, rather, the statutory
23 rate, which means that that negotiation occurs in
24 the shadow of the statutory rate.

25 And so it doesn't purely fit within the

1 willing buyer/willing seller framework for those
2 reasons.

3 Q. So have you modified your view on that
4 topic since you were asked that question at your
5 January deposition?

6 A. I am obviously informed by the additional
7 work that I have done. I don't remember my precise
8 answer to that question, but in my view, I think
9 what I was saying at the time was that my -- that
10 the degree of competition in the two markets was
11 approaching the similar levels.

12 Q. I think what you actually said in your
13 deposition was it was a fair proposition in response
14 to being asked whether direct licenses have been
15 negotiated under workably competitive conditions?

16 A. In -- I think my answer right now is the
17 market involving Sirius is yes, for the reasons I
18 just articulated, but you have to -- it is in the
19 shadow of that regulation.

20 Q. Now, in your view Sirius XM should pay
21 either a percentage-of-revenue rate or a
22 per-subscriber rate, correct?

23 A. I -- mine are equal, so I am proposing
24 one or the other, and so because I have, through my
25 methodology, I have equated those two, it is six one

1 way-half dozen another.

2 Q. But you are not proposing a greater-of
3 payment metric, are you?

4 A. I have not put in my testimony a
5 greater-of metric.

6 JUDGE STRICKLER: Was that an intentional
7 omission?

8 THE WITNESS: No. I was just proposing
9 an approach to come up with the analysis in terms of
10 equating the per subscriber and the
11 percentage-of-revenue. If you went to the pure
12 benchmark, the pure benchmarks are obviously using
13 greater-of provisions, but I was seeking to just
14 measure what the current market rates are and what
15 would be an appropriate level for the rate for
16 Sirius XM.

17 JUDGE STRICKLER: Thank you.

18 MR. RICH: For the last segment, which is
19 brief, Your Honors, in my examination we should go
20 on the restricted record.

21 JUDGE BARNETT: We will ask anyone in the
22 room who is not privy to restricted information to
23 please wait outside.

24 (Whereupon, the trial proceeded in
25 confidential session.)

1 O P E N S E S S I O N

2 MR. HANDZO: Although if I go ahead, I
3 will be done before they get in.

4 JUDGE BARNETT: That's fine.

5 REDIRECT EXAMINATION

6 BY MR. HANDZO:

7 Q. Just a couple of questions, Mr. Orszag.
8 And I won't ask you to play with any numbers.

9 Somewhere this morning I think you were
10 being asked about anti-steering provisions. And you
11 talked about cases that have found that they can be
12 pro-competitive. Do you have any particular case or
13 cases in mind?

14 A. The case that comes to mind is the
15 Appeals Court in American Express where I believe a
16 District Court -- and this just -- I defer to others
17 who may know more about this. The District Court
18 ruled the anti-steering provision in that case was
19 anticompetitive and the Appeals Court overruled the
20 District Court and wrote pretty explicitly about the
21 pro-competitive nature of such anti-steering
22 provisions.

23 Q. Do you recall if that was the Second
24 Circuit?

25 A. I believe the Second Circuit because the

1 case was in New York, so that would make sense.

2 Q. And then at the very outset Mr. Rich
3 asked you some questions about your qualifications
4 and asked you about certain cases that you had
5 worked on.

6 He didn't ask you about FTC versus
7 Staples and Office Depot. Do you recall that case?

8 A. Yes, I do.

9 Q. What was that case about?

10 A. A merger of two office supply firms, one
11 was Staples and one was Office Depot. They were
12 seeking to merge. And the FTC sought to block the
13 merger. And so I was the witness for the parties
14 for Staples and Office Depot.

15 Q. And what law firm engaged you for that
16 case?

17 A. I was engaged both by Simpson Thatcher,
18 who represented Office Depot, and Weil Gotshal who
19 represented Staples.

20 Q. And was that the first time you have ever
21 been engaged by Weil Gotshal?

22 A. No, it is not.

23 MR. HANDZO: Thank you. That's all I
24 have.

25 MR. RICH: One question, Your Honor?

1 JUDGE BARNETT: Sure.

2 RECROSS-EXAMINATION

3 BY MR. RICH:

4 Q. It may be an exercise in self-mutilation.
5 What was the outcome of the Staples
6 trial?

7 A. I did not testify in the case. There was
8 a decision by counsel to rest the defense prior to
9 any defense, so I ultimately did not testify in
10 court. And the judge ruled to block that merger.

11 Q. Against the advocacy which you were
12 making and would have made on the stand, correct?

13 A. I never made the advocacy. I never
14 presented my testimony in front of the judge. So
15 the answer is the judge explicitly noted the fact
16 that given the fact that I hadn't testified, he
17 couldn't rely on anything that I had --

18 Q. But adverse to the parties whom you
19 consulted, correct? The decision was adverse to the
20 parties whom you acted as a consultant for, correct?

21 A. That is correct.

22 MR. RICH: Thank you. No further
23 questions.

24 JUDGE BARNETT: Anything further? Thank
25 you, Mr. Orszag. You may be excused.

1 THE WITNESS: Thank you very much.

2 MR. HANDZO: I think we're prepared to
3 call our next witness, Professor Lys. I just need a
4 moment to move the deck chairs around.

5 JUDGE BARNETT: Okay. Why don't we take
6 about a five-minute break just to shift gears.

7 (A recess was taken at 2:12 p.m., after
8 which the hearing resumed at 2:21 p.m.)

9 JUDGE BARNETT: Please be seated, all but
10 the witness. Please raise your right hand.
11 Whereupon--

12 THOMAS LYS,
13 having been first duly sworn, was examined and
14 testified as follows:

15 JUDGE BARNETT: Please be seated.

16 MR. WARREN: Good afternoon, Your Honors.

17 MR. TOLIN: I don't mean to interrupt. I
18 am Adam Tolin from Weil on behalf of Sirius. It is
19 a pleasure to be here.

20 Before Professor Lys's direct examination
21 begins, I wanted to put on the record that we have a
22 pending motion in limine to strike a portion, a
23 section of Professor Lys' rebuttal testimony. And I
24 should note that it does impact five of the slides
25 that I think counsel intends to use on direct

1 examination.

2 I am happy to argue it now or if you
3 would prefer another time, we can take it up, but
4 there will be at least five slides that are taken
5 from that very portion that we believe should be
6 stricken.

7 JUDGE BARNETT: Why don't we wait until
8 we get there, and then we will decide what to do
9 next. Thank you, Mr. Tolin.

10 MR. TOLIN: Thank you.

11 JUDGE BARNETT: Judge Feder just reminded
12 me, it is a demonstrative, so it wouldn't be
13 admitted anyway. It is just illustrative of his
14 testimony. It is not admissible.

15 MR. TOLIN: That's true. Thank you.

16 JUDGE BARNETT: Okay.

17 MR. WARREN: Good afternoon, Your Honors.
18 Before I have the witness introduce himself, I
19 thought I should introduce myself. My name is
20 Previn Warren. And I am counsel for SoundExchange
21 and the other rightsholders participants, along with
22 Mr. Handzo, wherever he disappeared off to, and the
23 other attorneys at Jenner & Block.

24 We do have one bit of housekeeping as
25 well. Prior to this morning's proceedings, counsel

1 for Sirius XM and I reached agreement on the
2 admissibility of three additional exhibits. I would
3 seek now to move those exhibits into evidence as
4 they are unopposed. Those are Exhibits 172, 174,
5 and 311.

6 JUDGE BARNETT: Hearing no objection,
7 those three exhibits are admitted.

8 (SoundExchange Exhibit Numbers 172, 174
9 and 311 were marked and received into evidence.)

10 MR. WARREN: Thank you, Your Honor.

11 DIRECT EXAMINATION

12 BY MR. WARREN:

13 Q. Professor Lys, could you please introduce
14 yourself.

15 A. Yes, my name is Thomas Lys. I'm a
16 professor emeritus at the Kellogg School at
17 Northwestern University.

18 Q. And, Professor, what is your educational
19 background?

20 A. I have a degree in economics from the
21 University of Bern in Switzerland. And I have a
22 Ph.D. in accounting and finance from the University
23 of Rochester.

24 Q. How long have you been a professor?

25 A. So my active professorship was 35 years.

1 And for the last two years and the next one year, I
2 will be a professor emeritus in service and
3 thereafter just a professor emeritus.

4 Q. And what is the difference between
5 professor emeritus in service and professor
6 emeritus?

7 A. As far as I can tell, this is a newly
8 invented category. When I was negotiating my
9 emeritus transition, I still had two Ph.D. students
10 in the pipeline. And I thought it would be unfair
11 to them to abandon them mid-stream.

12 And so one of the items I insist on
13 negotiating was that I would be able to act as the
14 chairperson for their dissertation. And that
15 required a different status with the university.

16 Otherwise, emeriti are not allowed, is my
17 understanding, to serve as chairpersons of a
18 dissertation committee.

19 Q. Professor, what subjects have you taught
20 over the course of your career?

21 A. So I have taught accounting, finance, and
22 economics, econometrics, the standard classes. And
23 then I have also moved into behavioral finance and
24 behavioral economics. And also that led me to the
25 field of negotiations, which is kind of my youngest

1 venture in academia.

2 Q. Professor, besides the Kellogg School at
3 Northwestern, where else have you taught?

4 A. So I taught at the University of Chicago,
5 and I taught and I am still teaching at Stanford. I
6 taught at Stanford as a visiting professor, but I
7 also taught and I am still teaching in their
8 executive program. And I teach there the field of
9 negotiations.

10 Q. Tell us briefly about your research.

11 A. So my research began kind of traditional
12 where an accounting and finance Ph.D. would do, in
13 the security markets, in competition, in control,
14 disclosure, things of that nature.

15 Since then I have evolved slowly into
16 more the behavioral field. So my more recent paper
17 dealt with corporate social responsibility. I have
18 published a book on negotiation just recently two
19 years ago, so it kind of has evolved from the hard
20 core part of economics to the, for lack of a better
21 word, softer side of economics.

22 Q. And have you been the editor of any
23 peer-reviewed journals?

24 A. Yes, for 11 years I have been one of the
25 editors of one of the top journals in the financial

1 economics field. It is the Journal of Accounting
2 and Economics. In terms of impact factor, I think
3 it is -- it was ranked Number 2, if my recollection
4 is correct. This is a measure of how many other
5 researchers are influenced by articles published in
6 a given journal.

7 Q. Has your own research been published in
8 any peer-reviewed journals?

9 A. Yes. I have approximately 35 refereed
10 publications in a multitude of journals starting
11 from the Journal of Accounting and Economics,
12 Journal of Financial Economics, Journal of
13 Monitoring Economics, Journal of Business, the
14 accounting review. I even -- it is not refereed,
15 but I have an article in the Harvard Business
16 Review.

17 Q. Professor, you mentioned that you have
18 increasingly been interested in behavioral finance.
19 Can you tell us a little bit about that area of
20 research for you?

21 A. Yes. It is a fascinating field. What it
22 turns out, economics is a very strong field. And it
23 explains a lot. But it also leaves a lot of issues
24 not explained, and so issues of fairness and how
25 people deviate from the optimal path.

1 And at Kellogg, and then my partner moved
2 to Stanford. I was exposed to a more
3 psychology-driven part of business education. And
4 that led me to try to collaborate with her. And
5 what we did is we developed a methodology where you
6 start with, you know, economics like game theory or
7 just standard macro/microeconomics and then you say:
8 Well, how would people deviate from this optimal
9 behavior, and you know, paying attention to sunk
10 costs, when we know you shouldn't?

11 Being anchored, so I'm going to give you
12 a number and the number might be irrelevant, but you
13 can't get it out of your mind.

14 And so that's where kind of the
15 behavioral part comes in, that people sometimes
16 deviate from kind of the basic tenets of game
17 theory, sometimes referred to as classical
18 economics.

19 Q. Professor, you mentioned that you had
20 taught negotiation. Where have you taught that
21 course?

22 A. So the course is taught at Stanford.
23 That has gone now for, on and off for about ten
24 years. But we are also taking this on the road.
25 There is a very high demand.

1 It is actually very popular right now to
2 try to combine economics and psychology. And a lot
3 of people have realized that neither one alone does
4 a very good job in explaining human behavior.

5 And so my partner and I have been giving
6 lectures worldwide. We have done the Middle East,
7 both Israel and Saudi Arabia and Kuwait and Dubai.
8 We have gone to Europe. We have lectured in
9 Switzerland and in Holland. And there were a few
10 more, but it is very popular right now.

11 And both -- also in the Americas, both
12 North and South America.

13 Q. Professor, have you been qualified as an
14 expert in any prior proceedings?

15 A. Yes, I think this is my third appearance
16 in this court. I have been in SDARS II, and I have
17 been in Web IV. And this is my third appearance in
18 SDARS III.

19 I have also submitted reports and been
20 deposed in what is sometimes referred to as the
21 underpayment case, so -- that's -- I don't know how
22 to count that.

23 Q. Professor, I would direct your attention
24 to Exhibit 25, which is in the first binder of the
25 three. And this is your written direct testimony.

1 A. Yes.

2 Q. Could I direct your attention to Appendix

3 A at the back of --

4 A. You said binder 3?

5 Q. It is binder 1 of 3.

6 A. Oh, okay, I'm sorry.

7 Q. And this binder just contains your

8 testimony and Professor Shapiro's testimony for

9 future reference.

10 A. Okay.

11 Q. If you could take a look at Appendix A to

12 your written direct testimony.

13 A. Yes, I am there.

14 Q. What is that?

15 A. So this is my curriculum vitae. It

16 starts with the academic portions, my publications,

17 and then working papers, books, et cetera. And then

18 it lists cases that I was involved with.

19 Q. Is there anything missing from this copy

20 of your CV?

21 A. Yes. It is almost embarrassing, Your

22 Honors, I forgot to list Web IV. I hope you still

23 remember me, though.

24 Q. Is your CV otherwise accurate?

25 A. Yeah, I think so.

1 MR. WARREN: Your Honors, at this time I
2 would qualify Professor Lys as an expert in
3 financial economics, behavioral economics, and
4 negotiation.

5 MR. TOLIN: Your Honor, we would object
6 to Professor Lys being qualified in the field of
7 economics. No objection in the fields of finance
8 and accounting.

9 And if you would prefer or allow, I am
10 happy to voir dire him now or if it is -- if you so
11 desire, I can include that as part of my
12 cross-examination probably tomorrow but our
13 objection is specifically with respect to qualifying
14 Professor Lys in the field of economics.

15 JUDGE BARNETT: Why don't you conduct
16 your voir dire now.

17 VOIR DIRE EXAMINATION

18 BY MR. TOLIN:

19 Q. Good afternoon, Professor Lys.

20 A. Good afternoon.

21 Q. Why don't we start with the document that
22 counsel was just reviewing with you, your CV,
23 Appendix A --

24 A. Okay.

25 Q. -- to your written direct testimony. And

1 as you note, you have no Ph.D. in economics,
2 correct?

3 A. No, I have a degree from the University
4 of Bern, which is somewhere between a bachelor and a
5 master. And I would like to point out I graduated
6 summa cum laude.

7 Q. Then you attended the University of
8 Rochester here in the United States and received a
9 Ph.D. in accounting and finance, correct?

10 A. Well, yes, but you have to understand
11 that economics is the base discipline in accounting
12 and finance. So that's the underlying discipline.
13 And I would also like to point out that in my class,
14 of the entire Ph.D. class of my year, which were
15 roughly 17 students, I scored highest on the Econ
16 exam.

17 Q. You could have gotten a Ph.D. in
18 economics, those things exist. You chose not to get
19 a Ph.D. in economics. True?

20 A. Well, I don't think you can separate
21 these things. I think economics is the base
22 discipline of finance and accounting and many
23 others, so while my designation of a Ph.D. is not
24 economics, I think it is simply not true that you
25 can go through this without passing all the exams in

1 economics. In fact, as I told you, I did so much
2 micro, I was asking myself where is the accounting
3 or where is the finance?

4 Q. If you stay on page A-1 of your CV.

5 A. Yes.

6 Q. Under Academic Appointments, you identify
7 all the different roles you have had at Kellogg over
8 the past couple of decades, right?

9 A. Yes.

10 Q. And your roles began back in 1981. You
11 were an assistant professor of accounting and
12 information systems, right?

13 A. Correct.

14 Q. And you had that role until 1989 at which
15 point you -- pardon, all the way up to 1995. True?

16 A. That's correct.

17 Q. And then from 1995 to 1997 again you were
18 a professor of accounting and information systems
19 with a distinguished title, true?

20 A. Yes, but that -- those only refer which
21 department I lived in. This does not refer to what
22 I conducted research on or what I taught and what my
23 roles were.

24 Q. Your titles in terms of your
25 professorship at Kellogg have always been with

1 respect to accounting and finance and never with
2 respect to economics; fair?

3 A. That's true, but I think you are
4 misinterpreting how academia works.

5 Q. If we can, I would like to put up the web
6 site for the Kellogg School. Joe, if you can do
7 that, it should appear on the screens for everyone.

8 And you see here this is your page on the
9 Kellogg web site, right?

10 A. Correct.

11 Q. Here in the overview it identifies in
12 summary fashion your background and your training
13 and the various courses you have taught, right?

14 A. That's correct, yes.

15 Q. All right. And there is a link on the
16 left-hand side of the page, the fourth link down
17 that is titled Faculty Experts Guide. Do you see
18 that?

19 A. Correct.

20 Q. And that, if you click on it, Joe, if you
21 could do that, please, it takes you to another page
22 where the faculty at Kellogg identify the specific
23 faculty that are experts within the various
24 disciplines.

25 Do you see that?

1 A. Yes.

2 Q. And so the very first one, accounting
3 information and management, if you expand it and you
4 hit the plus, it identifies, and I counted, it is
5 approximately 25 different subspecialties.

6 A. Yeah.

7 Q. And you are identified as an expert
8 faculty member in a number of those fields, right?

9 A. I have to tell you I have never visited
10 this web site.

11 Q. Let's just for the sake of just
12 completing this, why don't we click on financial
13 accounting. And you will see that it identifies a
14 number of expert faculty members in that discipline.
15 And you see your name down there, the fifth name
16 listed, right?

17 A. Yes.

18 Q. If we can go back, Joe, if you scroll
19 down this page you see there is the field of
20 economics that's identified, right?

21 A. Yes.

22 Q. And if you expand that, there are 28
23 different subspecialties ranging from applied
24 probability, econometrics, economic models, and I
25 can represent to you I -- I clicked on each and

1 every one of them, your name is not identified as an
2 expert faculty member under any one of those
3 subspecialties within the field of economics.

4 Did you know that?

5 A. I didn't know that, but I don't think
6 that's the way how you will assess my expertise. I
7 have published -- I have published in those fields.

8 JUDGE STRICKLER: Let me just interject
9 for a second. I think I saw this correctly in the
10 transcript that he was proffered as an expert in
11 financial economics, behavioral economics, and
12 negotiations.

13 And you went rather quickly through the
14 subsections on the screen here, and maybe we can go
15 back. I am looking at the economics is on the
16 screen here, and I don't see any separate section
17 within this University with regard to financial
18 economics.

19 If you can click back, if the gentleman
20 could click back to the accounting, I don't think we
21 have a separate subheading of financial economics
22 either. So perhaps the witness can explain how
23 financial economics either does or does not overlap
24 those two sections?

25 THE WITNESS: So academic specialties and

1 these consulting opportunities, the purpose of this
2 web site is not to qualify professors or not
3 qualify. My vague recollection is that there is a
4 secretary in the dean's office and she asks you, you
5 know, we're trying to promote the faculty for the
6 consulting income, which is outside of the academic
7 activity, we allow you to have one day a week of
8 consulting without violating the loyalty to the
9 university, et cetera, where would you like to be
10 listed?

11 And so I could be -- I could say well,
12 put the category for entertainment, I would like to
13 tell jokes. And she would put --

14 JUDGE STRICKLER: I am not so interested
15 in the secretary's sense of humor or anything else,
16 but maybe you can define the field if it is, indeed,
17 a field or hybrid field of financial economics.

18 THE WITNESS: So, first of all, virtually
19 all the fields in the hard core part of the business
20 school have the basic discipline of economics as
21 underlying.

22 So all the people that are in finance, in
23 economics, in accounting have actually passed
24 economics exams in the Ph.D. because it is required.

25 JUDGE STRICKLER: So you took economics

1 courses at the graduate level to get your Ph.D.?

2 THE WITNESS: Of course, yes. In fact, I
3 scored highest of the entire class, including those
4 that later on were listed under economics. So this
5 is the basic discipline.

6 And the accounting, finance, real estate,
7 et cetera, are application of economics to specific
8 institutional settings. So financial economics
9 deals with how investors react to disclosure, for
10 example.

11 And how do investors value companies? It
12 is a special setting, but the base discipline is
13 economics. And, look, what is finance? Finance is
14 economics applied with a time dimension. Whether
15 everything happening at one point in time, you add
16 the question of multiple periods. And now how will
17 you substitute from one period to the other?

18 But it is economics. It is simply adding
19 a time dimension. Accounting is economics with
20 adding the disclosure dimension to the field of
21 economics.

22 So to make the distinction counsel wants,
23 particularly from a web site whose main purpose is
24 to provide consulting income to the faculty, I think
25 is, how to say it, I'm surprised.

1 JUDGE STRICKLER: Thank you.

2 BY MR. TOLIN:

3 Q. As I have come to learn as a trend in
4 this, Judge Strickler did anticipate my next
5 question.

6 I wrote down that counsel attempted to
7 qualify you in the field of behavioral economics as
8 well. And there is a discipline, a sub-discipline
9 identified on the Kellogg faculty web site,
10 behavioral economics. And, Joe, if you could click
11 on that.

12 And if you scroll down we don't see your
13 name listed there. So your faculty colleagues at
14 the Kellogg School identified you as an expert in a
15 variety of fields within accounting and finance, but
16 not in the field of behavioral economics, right?

17 A. No, I mean, this is -- this is really
18 silly. I have never gone to the person that
19 services this and says: Could you please put me on
20 the following list? I found it not necessary.

21 But that does not -- you know, this is
22 not any kind of peer-review involved in this. This
23 is simply would you like to be included in this
24 club?

25 And I never saw a need or necessity or

1 any benefits of going to this administrator who runs
2 this web site and tell: Please add me to this list.
3 Had I done so? I could have been on every one of
4 them. I mean, there is no entry exam in being
5 listed there.

6 JUDGE STRICKLER: Trying to put these two
7 strands together for the moment, you explained your
8 background in financial economics. And you just
9 gave a fairly exhaustive answer in that regard. And
10 you said over a years, a moment ago, that your
11 experience has become more specialized in behavioral
12 finance.

13 THE WITNESS: Yes.

14 JUDGE STRICKLER: So you have explained
15 the financial underpinning, the economic
16 underpinnings of finance. What are the behavioral
17 underpinnings?

18 THE WITNESS: So I have developed a set
19 of materials, since my colleague is a psychologist,
20 and we have actually offered the class called
21 behavioral finance. And I have taught that both in
22 the degree program at Kellogg and also in several
23 non-degree programs.

24 And also if Your Honors, and I'm sorry to
25 advertise, but if you were to buy my book, and I

1 hope you do, it is an excellent book. You would see
2 that the pitch in the book is the combination of
3 traditional economics and psychology.

4 And so this is the integration. And I am
5 50 percent of that book.

6 JUDGE STRICKLER: Thank you.

7 BY MR. TOLIN:

8 Q. Just a few more questions on this topic.
9 The Analysis Group is the consulting firm that you
10 are associated with and that was retained in this
11 matter by SoundExchange; is that right?

12 A. No, that's not right.

13 Q. Explain if you would for the record your
14 analysis to The Analysis Group?

15 A. They -- The Analysis Group is a
16 consulting firm, and they offer their services to
17 different parties that are in litigation, among
18 others. It is a consulting firm.

19 And they have their own experts. And
20 they also have what are called affiliate experts,
21 academic affiliates. And I have worked with them.
22 I have worked with two other firms as an academic
23 affiliate.

24 Q. So if we could, Joe, if we could pull up
25 The Analysis Group web site that also has a bio for

1 you on it. Do you see that there on your screen,
2 Professor Lys?

3 A. Yes. I think it is a very nice picture
4 of me.

5 Q. And under Summary of Experience, The
6 Analysis Group writes, "Professor Lys is an expert
7 in accounting and finance, including real estate
8 finance, financial reporting, securities analysis,
9 and mergers and acquisitions."

10 A. Yeah.

11 Q. The Analysis Group does not identify you
12 as part of its advertising campaign here as an
13 expert in economics, right?

14 A. Again, you know, this is, this is a
15 marketing tool, and I don't know why they decided to
16 do that. They may have simply taken things from the
17 web site of Northwestern. I don't know. This is,
18 again, this has no gatekeeping function.

19 And I could have told them to add ballet
20 dancing on it, and there would have been a line that
21 I am also an expert in ballet.

22 Q. We have looked at two different places,
23 both your academic affiliated web site and this
24 consulting group that you work for, and they have
25 identified you as an accounting and finance expert

1 but not an economist, right?

2 A. Yeah, but it is not a qualification.

3 There is no entry gatekeeper here. This is -- this
4 is simply a marketing tool. I think you are
5 misrepresenting or misunderstanding what is
6 happening here.

7 MR. TOLIN: I have no further questions
8 on qualifications.

9 MR. WARREN: Your Honor, if I may, I have
10 a few questions.

11 JUDGE BARNETT: Yes.

12 MR. WARREN: Thank you.

13 DIRECT EXAMINATION -- Resumed

14 BY MR. WARREN:

15 Q. Hello, Professor.

16 A. Hello.

17 Q. If I could direct you to the same
18 Appendix A that counsel was previously asking you
19 questions about.

20 A. Yes.

21 Q. And I would like to ask you about some of
22 the publications identified in that curriculum
23 vitae.

24 A. Yes.

25 Q. So let's start under publications/books

1 on page A-4. Do you see that page?

2 A. Yes.

3 Q. And there is a couple entries there.

4 One, "Economic Analysis and Political Etiology, the
5 Collected Essays of Karl Brunner"?

6 A. Yes.

7 Q. And above that "Monetary Theory and
8 Monetary Policy, the Collected Essays of Karl
9 Brunner."

10 A. Yes.

11 Q. Did those publications involve economics?

12 A. Yes, Karl Brunner was my mentor. And
13 when he was in the final stages of his life, he
14 asked me to publish these collected essays. And I
15 made that promise to him. And I acted as editor
16 fulfilling that promise.

17 Q. Okay. And then above that in numbered
18 item 4 there is an article you wrote entitled "Daily
19 Monetary Impulses and Security Prices." Where was
20 that published?

21 A. That's -- that's published in the Journal
22 of Monitoring Economics.

23 Q. Did that involve economics?

24 A. Yes.

25 Q. On the next page A-3, sorry, a page

1 earlier, Number 6, "An Empirical Analysis of the
2 Incentives to Engage in Costly Information
3 Acquisition: The Case of Risk Arbitrage."

4 Where was that published?

5 A. Journal of Financial Economics. And let
6 me emphasize these journals add the word "economics"
7 in the title because the ground discipline, the
8 underlying discipline is economics.

9 Q. Okay. And then Number 9, "The Market For
10 Audit Services: Evidence From Voluntary Auditor
11 Changes," where was that published?

12 A. Journal of Accounting and Economics.

13 Q. Did that article involve economics?

14 A. Of course. They all do.

15 Q. Okay. And 11, "Research Design Issues in
16 Grouping-Based Tests," where was that published?

17 A. That was published in the Journal of
18 Financial Economics. And that incidentally is an
19 econometrics paper. It is almost pure, pure
20 econometrics statistics.

21 Q. And I have -- so that we're not here all
22 day, I take it there is several other publications
23 that you have published in the Journal of Financial
24 Economics and the Journal of Accounting and
25 Economics; is that correct?

1 A. That's correct.

2 Q. And did those publications, in fact,
3 involve economics?

4 A. Of course.

5 Q. Now, I see here on page A-5 editorial
6 positions. You are listed as the editor of the
7 Journal of Accounting and Economics from 1999 to
8 2010. Is that right?

9 A. That's correct.

10 Q. Did you, in fact, have to review any
11 manuscripts concerning economics in your role as
12 editor of the Journal of Accounting and Economics?

13 A. I reviewed approximately 650 manuscripts.
14 And a large number of them involved economics,
15 economic modeling, and econometrics. Are usually
16 when something involves the editors of the journal,
17 there were at the time four or five editors, I don't
18 remember, have their specialties.

19 And when something was squarely
20 economics, more likely than not I was the one to
21 whom the paper was assigned to.

22 Q. Now, Professor, you stated that you have
23 previously been qualified as an expert in
24 proceedings before the Copyright Royalty Board.
25 Have you been qualified as an expert in any other

1 proceedings besides CRB proceedings?

2 A. Before this Board or in general?

3 Q. Before any tribunal.

4 A. Yes, yes.

5 Q. On approximately how many occasions were
6 you qualified as an expert?

7 A. I would say at least two dozen where I
8 actually ended up in the testify -- I did probably
9 around 40 cases in my lifetime. But, you know, many
10 of them settle or, you know, et cetera. I probably
11 wrote reports in 35 or so of those.

12 Q. And in any of those cases were you
13 qualified as an expert in any sub-branch of
14 economics or economics itself?

15 A. Yeah, yeah, in virtually all of them.

16 Q. Are there any specific cases that come to
17 your attention that you think are relevant to your
18 qualifications as an expert in financial economics
19 or behavioral economics in this proceeding?

20 A. I would have to think about it. You
21 know, it is not the way I code things, so I would
22 have to think about that.

23 Q. Professor, were you an expert in any
24 cases involving Enron?

25 A. Yes.

1 Q. Can you tell us a little bit about that?

2 A. So Enron dealt with the consequences of
3 misreporting and misleading investors. And that
4 testimony included both disclosure issues, what is
5 proper disclosure, and also how would investors
6 reasonably respond to this disclosure. That's the
7 economics part.

8 MR. WARREN: Okay. Your Honors, I have
9 no further questions about Professor Lys'
10 qualifications. I would renew my motion to qualify
11 him as an expert in behavioral economics, financial
12 economics, and negotiation.

13 JUDGE BARNETT: Thank you. I want to
14 consult with my colleagues briefly.

15 MR. WARREN: Sure.

16 (Brief recess: 2:53-2:57 p.m.)

17 JUDGE BARNETT: Please be seated.

18 Even before today, obviously, the Judges
19 had reviewed the materials submitted by Dr. Lys, and
20 were familiar with his curriculum vitae from his
21 current submissions, as well as his previous
22 submissions.

23 As you are all aware, a witness may be
24 qualified as an expert by knowledge, skill,
25 experience, training, or education. Dr. Lys has all

1 of the necessary qualifications to be qualified as a
2 -- in the fields of financial economics, behavioral
3 economics, and --

4 MR. WARREN: Negotiations, Your Honor.

5 JUDGE BARNETT: -- negotiations. Thank
6 you.

7 MR. WARREN: Thank you.

8 BY MR. WARREN:

9 Q. All right, Professor.

10 Could you please take a look at
11 Exhibit 42, which is a copy of your written rebuttal
12 testimony.

13 A. Yes.

14 Q. Did you write this report?

15 A. Yes, I did.

16 Q. And if you could just turn to the
17 signature page near the end, which is across from
18 page C-4. It is up on your screen.

19 A. Yes.

20 Q. Is that your signature?

21 A. Yes, it is.

22 Q. Okay.

23 MR. WARREN: Your Honors, I move that
24 Exhibit 42 be admitted into evidence, which is the
25 written rebuttal testimony of Professor Lys.

1 MR. TOLIN: Subject to our motion in
2 limine that we discussed earlier, we have no
3 objection to the bulk of it. There is just one
4 section that we object to.

5 JUDGE BARNETT: Thank you. Then subject
6 to our being able to review that motion, we will
7 admit Exhibit 42.

8 Did you offer the written direct?

9 MR. WARREN: Yes, that's already been
10 admitted, Your Honor, unobjected to.

11 (Joint Exhibit Number 42 was marked and
12 received into evidence.)

13 JUDGE BARNETT: Okay. Thank you.

14 MR. WARREN: Thank you for the reminder,
15 though.

16 BY MR. WARREN:

17 Q. Professor, please direct your attention
18 to the screen. Are these the topics that you
19 addressed in your written testimony?

20 A. Yes, they are.

21 Q. And are these the topics that you intend
22 to cover today?

23 A. I hope so, yes.

24 Q. And tomorrow.

25 A. Yes.

1 Q. Can you briefly walk us through this
2 overview.

3 A. So the first one is something that was
4 already discussed several points, times, but what
5 would the SDARS I decision look like today if we
6 started that and updated it for the purchasing power
7 changes in the dollar.

8 And the second one is -- relates to the
9 performance of Sirius XM over the most recent past
10 since the merger in 208. And the third one is my
11 review of the direct licenses, which are a big part
12 of these proceedings.

13 And the fourth part is my analysis of the
14 two models that Professor Shapiro offers in support
15 of his testimony.

16 Q. Thank you, Professor.

17 So I take it we have some Greek in our
18 future. You said "208." Did you mean 2008?

19 A. Oh, yes, I'm sorry. I tend to make that
20 mistake all the time.

21 Q. All right. Now, Professor, are you
22 familiar with the SDARS I proceeding?

23 A. Yes.

24 Q. Were you a witness?

25 A. No, I was not.

1 Q. How are you familiar with SDARS I?

2 A. Well, obviously I was a witness in SDARS
3 II, and so the topic of SDARS I came up repeatedly
4 in those proceedings. I also, when preparing my
5 testimony, went back and refamiliarized myself with
6 at least the issues that I needed for this analysis.

7 Q. Tell us about the royalty rate that the
8 Judges reached in SDARS I.

9 A. So the beauty of SDARS I was that we
10 actually had a glimpse of what the Judges ruled as
11 being the market rate before applying any 801(b)
12 factors. And the number that they named there was
13 \$1.40, the most likely representative of the market
14 rate that would be prevailing in that period.

15 Q. And, Professor, when you say \$1.40, can
16 you put a metric on that, \$1.40 per what?

17 A. Per-subscriber, per month.

18 Q. Did the Judges convert that \$1.40
19 per-subscriber, per month into a
20 percentage-of-revenue rate?

21 A. Yes.

22 Q. And what was that rate?

23 A. That rate was 13 percent.

24 Q. Is that the rate they, in fact, set in
25 that proceeding?

1 A. No. And then they applied adjustments as
2 suggested by Section 801(b), and they came up, from
3 recollection now, starting at 6 percent escalating
4 from there.

5 Q. Have you attempted to calculate what the
6 \$1.40 per-subscriber rate would be in today's
7 dollars?

8 A. Yes, I did.

9 Q. And so please direct your attention to
10 the screen. Is this a fair and accurate
11 reproduction of figure 37 from your written direct
12 testimony?

13 A. It is.

14 Q. And what does this figure depict?

15 A. So it gives from the 2006 period, which
16 was the baseline, which is \$1.40 of per-subscriber
17 per month, I then computed for each year if you
18 adjust them simply for the CPI inflation through
19 2016, so that's the white column, second column,
20 gives you the actual CPI inflation rate. And the
21 right column gives you then the \$1.40 adjusted.

22 So what you have in this column is that
23 based on the CPI basket, this amount purchased the
24 same amount of that basket in every year.

25 JUDGE STRICKLER: Dr. Lys, you are

1 referring to the SDARS I determination and you said
2 one of the, at the outset, particularly good feature
3 of it is that there is a market rate that was
4 derived by the Judges at that time of \$1.40 per
5 subscriber before any impact with regard to the four
6 801(b)(1) factors, correct?

7 THE WITNESS: Correct.

8 JUDGE STRICKLER: That rate that was
9 derived -- well, first of all, let me ask you, aside
10 from knowing the rate from the SDARS I
11 determination, did you read the SDARS I
12 determination?

13 THE WITNESS: I read it, but I did not --
14 I'm not opining on it.

15 JUDGE STRICKLER: Do you know whether
16 that \$1.40 per-subscriber per month was based upon
17 the presence of a steering adjustment or the ability
18 of -- of Sirius or XM, those two entities at the
19 time, to be able to steer and whether or not that
20 issue was even developed in that proceeding?

21 THE WITNESS: I have not studied that.
22 And so I would have to say that at this point my
23 recollection is simply not precise enough to answer
24 your question.

25 JUDGE STRICKLER: So it is fair to say

1 you are saying the \$1.40 per-subscriber per month
2 rate was based on the evidence of a market rate as
3 presented and accepted and credited by the Judges in
4 that case, whatever that evidence may have been?

5 THE WITNESS: That's correct.

6 JUDGE STRICKLER: Thank you.

7 THE WITNESS: That's correct.

8 BY MR. WARREN:

9 Q. Professor, what is the \$1.40
10 per-subscriber rate when calculated in 2016 dollars?

11 A. So in 2016 dollars, you would have \$1.68.
12 That's the same purchasing power as the \$1.40 in
13 2006.

14 Q. And, again, how did you arrive at that
15 calculation?

16 A. Simply by adjusting each subsequent row
17 for the then prevailing inflation rate as determined
18 by the Consumer Price Index.

19 Q. Did Professor Shapiro compute a
20 per-subscriber rate that he thinks should be
21 applicable during this coming rate period?

22 A. I believe so, yes.

23 Q. And what was that rate?

24 A. That would be \$1.03.

25 Q. And do you have an opinion as to how that

1 \$1.03 is so different than the \$1.68 that would be
2 the SDARS I rate adjusted to 2016 dollars?

3 A. Well, Professor Shapiro, I think,
4 testified -- and, you know, I'm sure that his report
5 speaks for themselves -- but he determined it
6 without any respect to the SDARS I proceeding, he
7 just opined based on his comparison what that rate,
8 according to his beliefs or analyses would be in
9 2016, but it is roughly 40 percent less than would
10 be if you simply adjusted \$1.40 for inflation.

11 Q. And do you think that 40 percent
12 reduction from an inflation adjusted market rate is
13 warranted?

14 A. This is not something I studied.

15 Q. Professor, why did you adjust the SDARS I
16 per-subscriber rate instead of the rate established
17 in SDARS II?

18 A. Well, as I said in my introduction, the
19 beauty of SDARS I is that we got kind of the
20 intermediate results before application of the
21 801(b) factors. In SDARS II, we simply didn't get
22 that. We got the statutory rate after adjustments.
23 So it is impossible to know, at least from the
24 ruling, what the Judges believed was the market rate
25 at that time.

1 Q. Professor, have you attempted to
2 calculate what the \$1.68 per-subscriber rate would
3 be equal to when expressed as a
4 percentage-of-revenue rate?

5 A. Yes. So if you apply that to the gross
6 revenue in 2016, which is the method that has been
7 ruled, that would amount to 15.7 percent.

8 Q. Now, was part of your assignment to
9 analyze whether 15.7 percent is actually an
10 appropriate royalty rate?

11 A. No, not at all.

12 Q. Then what does a 15.7 percent royalty
13 rate represent to you?

14 A. So if you took the gross revenue in 2016
15 and multiplied it by 15.7, and divided by the number
16 of subscribers per month, you would get \$1.68. So
17 this is simply translating it into the gross revenue
18 as of 2016.

19 JUDGE STRICKLER: Just with this analysis
20 alone, before you get into further analyses, as you
21 have, this doesn't tell us whether the rate should
22 be -- percentage rate should be higher or even lower
23 than 15.7 percent, it just says if we extrapolate
24 out from SDARS I, this would be the rate?

25 THE WITNESS: Yes, but it offers another

1 window because if you think it is higher or lower,
2 then I think the focus should be what has changed
3 since 2006?

4 JUDGE STRICKLER: Well, that's why -- I'm
5 sorry. That's why I asked the question about what
6 evidence, if you had seen it, was in SDARS I. There
7 may be evidence that suggests it should be lower.
8 It might be the absence that evidence that suggests
9 it should be lower or there may be evidence or
10 absence of evidence that suggests it should be
11 higher, which of course you are going to talk about
12 in much greater detail in your testimony, but it
13 doesn't tell us anything other than bringing the
14 SDARS I rate up to present value in dollar terms.

15 THE WITNESS: Yes. Well, I hate to give
16 up so much territory, but --

17 JUDGE STRICKLER: Only if you have to.

18 THE WITNESS: Well, because I think there
19 is an importance there because it actually puts the
20 framework, right? If you want to say it is other
21 than 15.7 percent, then it kind of channels the
22 discussion of what has changed in which direction.

23 JUDGE STRICKLER: Well, you have a
24 background in behavioral finance and behavioral
25 economics, so it sounds like you are trying to tell

1 us don't follow a -- don't lose your path
2 dependence, look at this with fresh eyes. Is that
3 what you are really saying?

4 THE WITNESS: No, I am not trying to
5 anchor you.

6 JUDGE STRICKLER: That's what I am
7 saying. You are trying to unmoor us?

8 THE WITNESS: No, what I'm trying to do
9 is I'm trying to give you a framework by which to
10 evaluate another way of thinking about that. So if
11 you think it should be lower, then I'm giving you a
12 framework. What has changed since 2006 that would
13 make it lower?

14 So it is more like kind of giving you
15 analytic framework that allows you to evaluate
16 whether you are moving, from an economics
17 perspective, I am not testifying to any legal
18 aspects, in which direction to move and by how much.
19 But, again, this is -- how to adjust this \$1.68 is
20 not part of what I was asked to study.

21 JUDGE STRICKLER: Thank you.

22 BY MR. WARREN:

23 Q. Professor, following up on that idea,
24 have you examined whether a 15.7 percent of revenue
25 rate or \$1.68 per-subscriber rate would cause any

1 kind of disruptive impact on Sirius XM's business?

2 A. Yes, I have.

3 Q. And what did you conclude?

4 A. I concluded that it wouldn't be
5 disruptive in the least. I'm sure we're going to
6 dig into the details, but essentially I did what is
7 sometimes referred to in economics as a stress
8 analysis.

9 So what I did is I artificially increased
10 the rate and asked would Sirius XM from a financial
11 perspective be at risk in many, many dimensions.
12 And I have done this analysis two ways. One is I
13 have used 24 percent as the -- what if the statutory
14 rate were cranked up to 24 percent?

15 And then I asked the reverse question,
16 how high could that statutory rate be before,
17 relative to comparable companies, Sirius XM starts
18 falling off?

19 Q. So, Professor, I direct your attention to
20 the next screen, which is not restricted despite
21 having numbers. Can you explain for us what this
22 figure shows? And the first question is is this an
23 accurate reproduction of figure 33 from your written
24 direct testimony?

25 A. It is.

1 Q. Okay. What does this show?

2 A. So what I did is I chose three of the
3 most popular metrics by which financial economists
4 assess a company; how well it is doing. And so it
5 is return on assets, it is EBITDA, which is like an
6 operating cash flow, and it is free cash flow. That
7 means cash flows from operations minus investments.

8 And these are, you know, obviously every
9 financial analyst has their, his or her own metrics,
10 but this is probably the three most important
11 metrics that financial analysts would consider when
12 analyzing a company.

13 Q. Professor, before we dive into the
14 numbers, the right-hand column is labeled "average
15 for SIC 483." What does that mean?

16 A. Well, so this tries to put it into
17 context. And what we have in the United States is
18 we have companies grouped into industries. And the
19 reason to do so is I want to control for similar
20 economic conditions.

21 So -- and these classifications go
22 either, you know, four digits, three digits, two
23 digits, or one digit. The fewer digits, the coarser
24 the metric. So 483 is, includes both broadcasting,
25 so radio, and television.

1 If you went just broadcasting, it would
2 be 4832. So it would be an additional digit. I
3 have chosen to go to the 483 as opposed to 4832.

4 JUDGE STRICKLER: Dr. Lys, when you were
5 identifying performance metrics, were there some
6 that you considered and decided were not appropriate
7 for the task at hand?

8 THE WITNESS: No, no.

9 JUDGE STRICKLER: Did you consider
10 contribution margin?

11 THE WITNESS: No, I did not.

12 JUDGE STRICKLER: Why not?

13 THE WITNESS: Because contribution margin
14 by itself is not a relevant metric.

15 JUDGE STRICKLER: I may be getting ahead
16 of ourselves, but be that as it may, why not?

17 THE WITNESS: Because contribution
18 margin, without the number of sales revenue, tells
19 you nothing. So you can have a contribution margin
20 of 70 percent and end up losing money. Why?
21 Because revenues simply are not large enough.

22 You can have contribution margin at
23 70 percent and you are making a ton of money. Why?
24 Because you have 30 million subscribers, and 30
25 million subscribers times \$12.50 a month.

1 JUDGE STRICKLER: One last question on
2 this, just so we have a framework. Can you define
3 contribution margin?

4 THE WITNESS: So contribution margin is
5 the difference between the price that the company
6 receives minus its variable costs, divided by the
7 sales price. So this essentially says of each sales
8 dollar, how much do I get to what is fixed costs and
9 profits?

10 So when, let's get real, Sirius XM has
11 contribution margin that starts a little bit below
12 70 percent and ends up a little bit above 70. But
13 let's use 70 percent as an example. For each
14 revenue dollar, Sirius XM gets 70 cents to cover its
15 fixed costs and then to create a profit.

16 So contribution margin is an important
17 metric, but by itself it tells you nothing because
18 it doesn't know at which level. Do you have enough
19 sales to even cover your fixed cost? You may have a
20 contribution margin of 70 percent, but you simply
21 don't sell enough widgets, and, therefore, you are
22 still losing money.

23 JUDGE STRICKLER: Because price received
24 in the formula for contribution margin doesn't refer
25 to revenues, it only refers to price?

1 THE WITNESS: No, it is price times
2 quantity, times N, the number of subscribers.

3 JUDGE STRICKLER: And why doesn't it
4 reflect revenue?

5 THE WITNESS: Well, that's revenue, the
6 product of those two is revenue. And so you need,
7 in order to make a profit, you need to have a large
8 contribution margin and lots of sales.

9 JUDGE STRICKLER: We will probably be
10 getting back to that, but thank you.

11 THE WITNESS: Yes.

12 BY MR. WARREN:

13 Q. Professor, do you intend to offer
14 testimony about contribution margin a little later
15 in your testimony?

16 A. Of course, yes.

17 Q. And just to close the loop on that, you
18 are saying that a company's profitability can
19 decline notwithstanding a stable contribution margin
20 if its sales goes down over time; is that right?

21 A. Yes. So let me maybe just add one more
22 thing to Judge Strickler's question. You see what
23 these metrics do is they allow you to compare across
24 companies just by themselves.

25 So if I told you the ROA for company 1 is

1 this and the ROA for company 2 is that, it will tell
2 you which one you want to invest your money in.

3 JUDGE STRICKLER: So you are saying --
4 I'm sorry, go ahead and finish your thought.

5 THE WITNESS: If I told you the
6 contribution margin of company 1 is this, and the
7 contribution margin of company 2 is that, by itself
8 you still didn't know which one is the better
9 company because one could have a lower contribution
10 margin but so much more sales that it actually is
11 more attractive.

12 And the company has a strategy, right? A
13 company can do business by having low fixed cost and
14 low variable cost or it can have high fixed cost and
15 lower variable cost. And these are results of its
16 decision, you know, more machines and less workers
17 or fewer machines and more workers. That's going to
18 change that mix.

19 And so by itself, if I told you one
20 company has a 70 percent contribution margin, and
21 the other one has only a 30, you still don't know
22 which one is the better company.

23 JUDGE STRICKLER: So contribution margin
24 is not a good metric to compare across companies?

25 THE WITNESS: That's right.

1 JUDGE STRICKLER: Is it a fair measure to
2 compare the position of one given company from one
3 point in time to another?

4 THE WITNESS: Look, I mean, so --

5 JUDGE STRICKLER: Can you answer that one
6 yes or no?

7 THE WITNESS: Yes.

8 JUDGE STRICKLER: And then an
9 explanation?

10 THE WITNESS: Yes, it is clear, I mean,
11 essentially what you are asking is would you rather
12 be rich and healthy, and the answer is yes, I would
13 rather have a higher contribution margin. So that
14 by itself, but I still don't know how even to
15 leverage it up.

16 JUDGE STRICKLER: Thank you.

17 BY MR. WARREN:

18 Q. So, Professor, just again to close the
19 loop, it is possible that a company's contribution
20 margin could be modestly increasing over time and
21 yet the company is becoming increasingly less
22 profitable over time?

23 A. Yes, if it, for example, loses
24 subscribers, or is no longer able to charge a
25 highest price per-subscriber.

1 Q. And if you looked just at the trend in
2 contribution margin, would you be able just using
3 that data point to assess the company's
4 profitability over time?

5 A. No.

6 Q. Okay. Now, let's return to this screen,
7 if we can. You said that SIC 483 includes radio and
8 TV companies; is that correct?

9 A. That's correct.

10 Q. Now, is it your understanding that Sirius
11 XM considers itself to compete with terrestrial
12 radio, meaning AM/FM?

13 A. Yes.

14 Q. And is that included in the SIC 483
15 category?

16 A. Yes, it is, to the extent that they are
17 public.

18 Q. Okay. So we have here one column that is
19 those companies and the other column is Sirius XM's
20 performance at a 24 percent royalty rate. Is that
21 right?

22 A. Yes, yes.

23 Q. Now how does Sirius XM at a 24 percent
24 royalty rate compare in terms of its return on
25 assets, assets, excuse me, to the SIC 483 companies?

1 A. Yes. So you can see it beats it by over
2 50 percent.

3 Q. And how does Sirius XM at a 24 percent
4 royalty rate compare to those other companies in
5 terms of EBITDA margin?

6 A. Again, it beats it by roughly 50 percent,
7 not quite, but almost.

8 Q. And what about free cash flow margin?

9 A. It beats it by a long mile. But let me
10 add, just so we're on the same page and the record
11 is clear, the stress test that I performed, Your
12 Honors, is a very conservative stress test because
13 while I have cranked up the royalty rate, I have not
14 allowed the company to pass on any of that to its
15 customers. Do you understand?

16 And we know that Sirius XM, in fact, does
17 pass on some of its to its music royalty. So in
18 reality -- and we know that in a perfectly
19 competitive market, you would pass on everything.
20 And in a monopolistic market, if you have market
21 power, you would pass on some, but not all,
22 depending on the elasticity of demand that you face.

23 So in reality, if we really did this
24 experiment correctly and allowed Sirius XM to pass
25 on some of the 24 percent to its customers, then its

1 ROA, its EBITDA margin, and its free cash flow
2 margins would be even higher.

3 Q. Okay. Professor, in order for us to set
4 those conclusions in context, I think it would help
5 if you could review some basics about Sirius XM's
6 financial performance.

7 I think we will have to close the
8 courtroom in a minute, but before we do that, in
9 terms of past performance, how has Sirius XM been
10 doing financially?

11 A. Fantastic.

12 Q. How do you know?

13 A. Well, I have analyzed it over, over the
14 past.

15 Q. And what measures did you consider when
16 assessing Sirius XM's fantastic financial
17 performance?

18 A. Well, I have looked at how its revenue
19 base grew. I looked at its cost and then ultimately
20 I looked at what really, really matters and that is
21 free cash flows.

22 Q. And, Professor, did you examine Sirius
23 XM's annual budgets in the course of that analysis?

24 A. Yes, I have.

25 Q. I would direct your attention to the

1 third binder, binder 3 of 3. I would like you to
2 take a quick skim through Exhibits 307, 308, 309,
3 and 310.

4 JUDGE BARNETT: Before we go there,
5 counsel, Professor, on your figure 33, you indicate
6 that the SIC category 483 includes broadcast radio
7 and television.

8 THE WITNESS: Correct.

9 JUDGE BARNETT: And that's network
10 television, correct, free television, not cable?

11 THE WITNESS: I need to check. I believe
12 there is also -- but that's something I would have
13 to ask Mr. Reitman -- no, just kidding.

14 (Laughter)

15 JUDGE BARNETT: Is there any breakout of
16 the television versus radio statistics?

17 THE WITNESS: No. But I could have done
18 it for 4832. That would have taken all the
19 televisions out.

20 JUDGE BARNETT: I see, okay.

21 THE WITNESS: And actually that category
22 looks terrible. A very large number of the
23 companies in the 4832 category actually lose money.

24 JUDGE BARNETT: So it looks terrible for
25 --

1 THE WITNESS: It makes the comparison
2 even more dramatic. And I just didn't want to have
3 such -- you know, I am not sure how many of those
4 will survive.

5 JUDGE BARNETT: Thank you.

6 BY MR. WARREN:

7 Q. And, Professor, I can direct your
8 attention and the Judges' attention as well to
9 Appendix B of your written direct testimony, page
10 B-1. And this actually appears to list the 25
11 companies that are included in SIC 483.

12 A. Let me go there. So this would be B-1,
13 you say? Yes.

14 Q. And this is just by way of reference. So
15 the kinds of companies included including CBS,
16 iHeart media, Pandora Media, Radio One, do you see
17 this?

18 A. Yes, yes.

19 Q. Okay. And 4832 is listed in Figure 74;
20 is that right?

21 A. Yes.

22 Q. Okay. So, Professor, I was about to have
23 you look at Exhibits 307 to 310. Could you just
24 briefly tell us what those are?

25 MR. TOLIN: I apologize for the

1 additional intrusion. For the record we would
2 object to the use of all four of these exhibits on
3 the grounds, if you just look at the title page of
4 each one --

5 JUDGE STRICKLER: Can you list the
6 exhibit number as you do that?

7 MR. TOLIN: It is 307. It looks like it
8 is in binder 3.

9 JUDGE STRICKLER: Thank you.

10 MR. WARREN: Your Honors, I would object
11 to the objection before I have actually sought to
12 move the exhibits into evidence because I would like
13 a chance for the Professor to actually tell us what
14 they are.

15 MR. TOLIN: Fair enough.

16 JUDGE BARNETT: Let's have him identify
17 them for the record.

18 MR. TOLIN: Fair enough. Thank you.

19 THE WITNESS: Okay. So these are
20 exhibits produced by Sirius XM, and these are
21 budgets for its upcoming years. So each one lists
22 the preliminary results for the year in which they
23 are produced and then what the budgets are for the
24 following year.

25 BY MR. WARREN:

1 Q. These are for years 2013, 2014, 2015, and
2 2016 respectively?

3 A. That's correct, yes.

4 Q. Okay. And you reviewed these and relied
5 on them in the course of your financial analysis?

6 A. Yes, I did.

7 Q. All right.

8 MR. WARREN: At this time, Your Honors, I
9 would move that Exhibits 307, 308, 309, and 310 be
10 admitted into evidence.

11 MR. TOLIN: And we would object, Your
12 Honor. If you look at the title to each one of
13 these, you will see for the first one, for example,
14 which is 307, it states 2012 preliminary results and
15 2013 budget. The same titles for the others.

16 And our objection is that Professor Lys
17 is not in a position to be a sponsoring witness to
18 lay the foundation for these documents. It is one
19 thing for him to review it and for him to have
20 relied on it. It is another to use it as a vehicle
21 to move into evidence, move into evidence documents
22 to which he doesn't have the personal knowledge.

23 As counsel knows, there is going to be
24 executives from Sirius who will testify, and we
25 would maintain that witnesses with actual personal

1 knowledge of the documents would be the appropriate
2 witnesses for which to lay the foundation and to
3 seek admission of these documents.

4 MR. WARREN: Your Honor --

5 JUDGE STRICKLER: Excuse me. I had
6 referred to these documents as having preliminary
7 results and then you said and so on, but, in fact,
8 309 and 3010 don't say preliminary, they say
9 results, right?

10 MR. TOLIN: I apologize, Your Honor.
11 That's true. Thank you for the correction. I
12 apologize. That is true for 307 and for 308. You
13 are right. That is not the case for 309 and for
14 310.

15 But, again, our objection is that
16 Professor Lys is not in a position to testify as to
17 the accuracy of the documents, despite the fact that
18 the last two say final results.

19 There will be a Sirius witness here who
20 we would maintain would be the right sponsoring
21 witness to the extent they can lay a foundation
22 through that witness.

23 MR. WARREN: And, Your Honors, I would
24 argue that this is an attempt to assert an
25 authenticity objection, which has already been

1 waived, and as that objection did not appear on the
2 joint exhibit list. I think the foundation is
3 established simply by virtue of the fact that
4 Professor Lys considered these documents and relied
5 on them, coupled with the fact that they were
6 produced by Sirius XM and bear Sirius XM's own Bates
7 numbers.

8 I think there is sufficient indicia of
9 reliability given that. And to the extent that
10 counsel or Sirius XM has an argument that there are
11 updated budgets that should be considered, I think
12 that speaks to the weight rather than the
13 admissibility of these documents.

14 And certainly in due course when the fact
15 witnesses arrive, those arguments could be heard.

16 JUDGE STRICKLER: Counsel, if I
17 understood you correctly, you are saying when Sirius
18 XM is going to put on fact witnesses who will, in
19 fact, lay a foundation for these documents and then
20 you will offer them in evidence?

21 MR. TOLIN: No, what I'm saying is if
22 they seek to admit this document or these series of
23 documents into evidence, they will have a witness
24 before them who they can seek to try to lay a
25 foundation with. This is not an authenticity

1 objection at all.

2 The question is there has to be a
3 sponsoring witness for the evidence. And our
4 position is Professor Lys is not in a position to
5 testify with any personal knowledge as to the
6 accuracy of these -- of this information.

7 He can rely on it and he can refer to it
8 and it can help him potentially inform his opinions
9 as Your Honors have set forth, but he can't be a
10 conduit to information to which he is not the right
11 sponsoring witness for.

12 JUDGE STRICKLER: But Sirius XM is not
13 intending to offer these into evidence?

14 MR. TOLIN: Candidly I am not sure of
15 that but my --

16 JUDGE BARNETT: Can you find that out?
17 Because if it is otherwise going to be in evidence,
18 that would be an important thing to know.

19 MR. TOLIN: My understanding is it is not
20 our intent to move in that evidence through direct
21 examination. But they will obviously have an
22 opportunity to use that document, those documents on
23 cross-examination, if they can lay the right
24 foundation.

25 MR. WARREN: Your Honor, I would simply

1 point out that by virtue of how the schedule in this
2 proceeding is set up, none of the fact witnesses
3 will be testifying before the expert witnesses are
4 done. So if that logic is extended, I don't think
5 any documents can really be moved into evidence
6 until the fact witnesses show up.

7 But that does not seem to be the right
8 course of action just simply by virtue of the fact
9 that we couldn't get the fact witnesses on the
10 stand, you know, in advance.

11 JUDGE BARNETT: Exhibits 307 and 308 will
12 be admitted not for the truth of the matter, since
13 they do say preliminary and it is a budget and we
14 don't really know what the actuals are for those
15 years.

16 309 and 310 are not so qualified and for
17 that reason can be admitted.

18 (SoundExchange Exhibit Numbers 307, 308,
19 309, 310 were marked and received into evidence.)

20 MR. WARREN: Thank you, Your Honors.

21 JUDGE STRICKLER: And are you offering
22 all of them, in any event, including the ones that
23 were preliminary for the purpose -- at least for the
24 purpose of establishing what this witness relied on?

25 MR. WARREN: Yes.

1 JUDGE BARNETT: Oh, did I not say that?
2 I'm sorry. I was thinking it, but it must be after
3 3:00. The first two --

4 JUDGE STRICKLER: You did say it, I'm
5 sorry. It is after 3:00.

6 (Laughter)

7 MR. WARREN: And I would say just as a
8 general concern that, of course, Professor Lys
9 doesn't work at Sirius XM and will not, if we are to
10 interpret the foundation objection in the broad
11 manner that counsel seems to assert, of course was
12 not present when any of these documents were
13 created, but be offering these into evidence to the
14 extent he relied on them and considered their
15 probative value in coming up with his own economic
16 assessment.

17 JUDGE BARNETT: Thank you.

18 MR. WARREN: Thank you, Your Honor.

19 BY MR. WARREN:

20 Q. Now at this time I would appreciate it if
21 we could close the courtroom. We're going to be
22 discussing some forecasts about Sirius XM's future
23 growth.

24 I think Sirius XM's personnel, of course,
25 can stay for this, they are privy to that

1 information. So I suppose this really only affects
2 Mr. Prendergast.

3 JUDGE BARNETT: We took an abbreviated
4 break earlier. Why don't we take another ten
5 minutes at this point and that will give people a
6 chance to sort themselves out.

7 (A recess was taken at 3:32 p.m., after
8 which the hearing resumed at 3:54 p.m.)

9 JUDGE BARNETT: Please be seated. Thank
10 you.

11 Mr. Warren, you were directing us to some
12 exhibits and asking that we close the hearing room;
13 is that right?

14 MR. WARREN: Yes, Your Honors. Thank
15 you.

16 JUDGE BARNETT: Sirius XM folks may stay,
17 correct?

18 MR. WARREN: Yes, Your Honor.

19 JUDGE BARNETT: But otherwise if you are
20 not privy to restricted information, I think
21 everyone has left already. Thank you.

22 (Whereupon, the trial proceeded in
23 confidential session.)

24

25

1 C O N T E N T S

2 WITNESS DIRECT CROSS REDIRECT RECROSS

3 JONATHAN ORSZAG

4 1092 1273 1275

5 THOMAS LYS

6 1278 VOIR DIRE: 1285

7 1297

8

9 AFTERNOON SESSION: 1225

10

11 CONFIDENTIAL SESSIONS: 1110-1189,

12 1210:4-5, 1263-1272, and 1334-1364

13

14 E X H I B I T S

15 EXHIBIT NO: MARKED/RECEIVED REJECTED

16 JOINT

17 42 1304

18 SoundExchange

19 112 1209

20 172 1278

21 173 1278

22 225 1353

23 307 1331

24 308 1331

25 309 1331

1	EXHIBIT NO:	MARKED/RECEIVED	REJECTED
2	SoundExchange		
3	310	1331	
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1 CERTIFICATE

2

3 I certify that the foregoing is a true and
4 accurate transcript, to the best of my skill and
5 ability, from my stenographic notes of this
6 proceeding.

7

8

9 4/27/17 Karen Brynteson

10 Date Signature of the Court Reporter

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REVISED AND CORRECTED TRANSCRIPT
OPEN SESSIONS

<p>\$</p> <p>\$1.03 [4] 1259:11,15 1309:24 1310:1</p> <p>\$1.40 [13] 1306:13,15,16,18 1307:6,16,21 1308:4,16 1309:1,9,12 1310:10</p> <p>\$1.68 [6] 1309:11 1310:1 1311:2,16 1313:19,25</p> <p>\$12.50 [1] 1316:25</p> <p>\$2.43 [2] 1197:5 1260:7</p> <hr/> <p>0</p> <p>000034493 [1] 1208:4</p> <p>00033362 [1] 1209:23</p> <p>08542 [1] 1090:16</p> <hr/> <p>1</p> <p>1 [13] 1104:12 1197:8 1201:21 1231:22 1232:14 1233:21 1235:3 1241:10,16,21 1284:5 1318:25 1319:6</p> <p>1:11 [1] 1225:2</p> <p>10 [2] 1097:23 1237:12</p> <p>10019-5874 [1] 1091:8</p> <p>101 [1] 1088:20</p> <p>10153 [1] 1090:10</p> <p>1040 [1] 1198:4</p> <p>1092 [1] 1365:4</p> <p>1099 [1] 1089:17</p> <p>11 [5] 1237:12 1253:9,15 1280:24 1299:15</p> <p>1110-1189 [1] 1365:11</p> <p>112 [1] 1365:19</p> <p>114 [1] 1240:5</p> <p>117 [2] 1207:1,6</p> <p>12 [2] 1106:17 1217:22</p> <p>12:04 [1] 1224:15</p> <p>1209 [1] 1365:19</p> <p>1210:4-5 [1] 1365:12</p> <p>122 [4] 1209:1,18,19 1211:6</p> <p>1225 [1] 1365:9</p> <p>123 [1] 1201:19</p> <p>1263-1272 [1] 1365:12</p> <p>1273 [1] 1365:4</p> <p>1275 [1] 1365:4</p> <p>1278 [4] 1365:6,20,21 1366:4</p> <p>1285 [1] 1365:6</p> <p>1297 [1] 1365:7</p> <p>13 [2] 1217:22 1306:23</p> <p>1304 [1] 1365:17</p> <p>1331 [4] 1365:23,24,25 1366:3</p> <p>1334-1364 [1] 1365:12</p> <p>1353 [1] 1365:22</p> <p>14 [3] 1216:6,11 1248:4</p> <p>15 [1] 1199:25</p> <p>15.7 [7] 1311:7,9,12,15,23 1312:21 1313:24</p> <p>16 [2] 1199:25 1208:5</p> <p>1675 [1] 1091:7</p> <p>17 [2] 1090:15 1286:15</p>	<p>1717 [1] 1091:13</p> <p>172 [3] 1278:4,8 1365:20</p> <p>173 [1] 1365:21</p> <p>174 [2] 1278:4,8</p> <p>1981 [1] 1287:10</p> <p>1989 [1] 1287:14</p> <p>1995 [2] 1287:15,17</p> <p>1997 [2] 1093:18 1287:17</p> <p>1999 [1] 1300:7</p> <p>1st [1] 1095:1</p> <hr/> <p>2</p> <p>2 [11] 1104:12 1232:24 1238:22 1240:11 1241:16,25 1242:8 1243:25 1281:3 1319:1,7</p> <p>2:12 [1] 1276:7</p> <p>2:21 [1] 1276:8</p> <p>2:53-2:57 [1] 1302:16</p> <p>20001 [1] 1089:18</p> <p>20006 [1] 1091:14</p> <p>2002 [1] 1093:23</p> <p>2006 [4] 1307:15 1309:13 1312:3 1313:12</p> <p>2008 [1] 1305:18</p> <p>2010 [1] 1300:8</p> <p>2012 [1] 1327:14</p> <p>2013 [2] 1327:1,15</p> <p>2014 [1] 1327:1</p> <p>2015 [4] 1094:23 1208:24 1237:11 1327:1</p> <p>2016 [12] 1094:24,25 1207:2 1307:19 1309:10,11 1310:2,9 1311:6,14,18 1327:2</p> <p>2017 [2] 1088:22 1096:1</p> <p>202-639-6000 [1] 1089:19</p> <p>202-857-6395 [1] 1091:15</p> <p>20362 [1] 1233:3</p> <p>208 [2] 1305:10,18</p> <p>212-310-8007 [1] 1090:11</p> <p>212-484-3990 [1] 1091:9</p> <p>22 [5] 1232:1,11 1234:16 1259:3,10 1227:7 [1] 1197:4</p> <p>225 [1] 1365:22</p> <p>23rd [1] 1096:3</p> <p>24 [7] 1212:4 1314:13,14 1321:20,23 1322:3,25</p> <p>25 [4] 1239:13 1283:24 1289:5 1325:10</p> <p>26 [3] 1088:22 1239:2 1241:1</p> <p>27 [1] 1103:9</p> <p>28 [5] 1197:5 1217:11 1232:20 1235:3 1289:22</p> <hr/> <p>3</p> <p>3 [10] 1197:5 1226:17 1228:21 1259:22 1260:8 1284:4,5 1324:1,1 1326:8</p> <p>3:00 [2] 1332:3,5</p> <p>3:32 [1] 1333:7</p> <p>3:54 [1] 1333:8</p>	<p>30 [9] 1190:11 1235:1,1 1250:1,8 1257:14 1316:24,24 1319:21</p> <p>30-day [1] 1251:1</p> <p>3010 [1] 1328:8</p> <p>307 [9] 1324:2 1325:23 1326:7 1327:9,14 1328:12 1331:11,18 1365:23</p> <p>308 [6] 1324:2 1327:9 1328:12 1331:11,18 1365:24</p> <p>309 [7] 1324:2 1327:9 1328:8,13 1331:16,19 1365:25</p> <p>310 [7] 1324:3 1325:23 1327:9 1328:14 1331:16,19 1366:3</p> <p>311 [3] 1278:5,9 1366:4</p> <p>32 [2] 1191:21 1235:2</p> <p>325189 [1] 1096:1</p> <p>33 [2] 1314:23 1324:5</p> <p>33362 [1] 1211:7</p> <p>34 [4] 1205:9,22 1220:12 1223:16</p> <p>35 [3] 1278:25 1281:9 1301:11</p> <p>37 [3] 1237:15 1238:12 1307:11</p> <p>39-a [2] 1199:23 1200:6</p> <p>39-b [1] 1200:17</p> <p>39-c [2] 1201:9 1210:16</p> <hr/> <p>4</p> <p>4 [2] 1247:1 1298:18</p> <p>4/27/17 [1] 1367:9</p> <p>40 [5] 1249:11,13 1301:9 1310:9,11 4000 [1] 1089:24</p> <p>41 [1] 1215:10</p> <p>42 [2] 1215:10 1303:11,24 1304:7,11 1365:17</p> <p>469 [2] 1259:8,24</p> <p>483 [3] 1315:15,24 1316:3 1321:7,14,25 1324:6 1325:11</p> <p>4832 [5] 1316:2,3 1324:18,23 1325:19</p> <p>49 [3] 1240:24,24 1241:2</p> <hr/> <p>5</p> <p>5 [2] 1097:23 1252:9</p> <p>50 [5] 1232:3 1233:9 1295:5 1322:2,6</p> <p>53 [2] 1212:5,12</p> <p>555 [1] 1089:24</p> <p>56 [2] 1234:11 1235:13 1241:9,17,22</p> <p>5th [1] 1095:6</p> <hr/> <p>6</p> <p>6 [2] 1299:1 1307:3</p> <p>60 [7] 1233:11 1234:11 1235:10,12 1249:11 1255:22 1256:1</p> <p>64 [1] 1256:6</p> <p>65 [4] 1233:11 1234:11 1235:11,13</p> <p>650 [1] 1300:13</p> <hr/> <p>7</p> <p>7 [2] 1204:4,6</p> <p>70 [9] 1233:10 1316:20,23 1317:12,</p>	<p>12,13,14,20 1319:20</p> <p>72 [1] 1211:5</p> <p>74 [1] 1325:19</p> <p>767 [1] 1090:9</p> <hr/> <p>8</p> <p>801(b) [6] 1103:3 1195:21 1196:10 1214:2 1218:19 1306:11 1307:2 1310:21</p> <p>801(b)(1) [2] 1213:20 1308:6</p> <p>809-986-1105 [1] 1090:17</p> <p>85 [1] 1246:1</p> <p>89 [1] 1253:8</p> <hr/> <p>9</p> <p>9 [2] 1228:23 1299:9</p> <p>9:07 [2] 1088:23 1092:2</p> <p>90 [2] 1240:8 1251:17</p> <p>900 [1] 1089:17</p> <p>90013 [1] 1089:25</p> <hr/> <p>A</p> <p>a-1 [1] 1287:4</p> <p>a-10 [1] 1100:5</p> <p>a-3 [1] 1298:25</p> <p>a-4 [1] 1298:1</p> <p>a-5 [1] 1300:5</p> <p>a.m [2] 1088:23 1092:2</p> <p>abandon [1] 1279:11</p> <p>abbreviated [1] 1333:3</p> <p>ability [9] 1195:17 1196:21 1197:20,21 1218:3 1239:25 1240:16 1308:17 1367:5</p> <p>able [6] 1227:2 1279:13 1304:6 1308:19 1320:24 1321:2</p> <p>above [4] 1215:12 1298:7,17 1317:12</p> <p>absence [2] 1312:8,10</p> <p>absolute [1] 1231:4</p> <p>academia [2] 1280:1 1288:4</p> <p>academic [9] 1093:12,22 1284:16 1287:6 1290:25 1291:6 1295:21,22 1296:23</p> <p>accept [1] 1253:17</p> <p>accepted [3] 1101:13,19 1309:3</p> <p>access [5] 1107:10 1247:14 1248:6,11 1260:22</p> <p>according [1] 1310:8</p> <p>account [8] 1196:21 1215:4 1216:6 1219:13 1230:21 1233:12 1240:13,21</p> <p>accounting [27] 1278:22 1279:21 1280:12 1281:1,11,14 1285:8 1286:9,11,22 1287:2,11,18 1288:1 1289:2,13 1290:20 1291:23 1292:6,19 1293:15 1296:7,25 1299:12,24 1300:7,12</p> <p>accuracy [2] 1328:17 1330:6</p> <p>accurate [5] 1226:20 1284:24 1307:10 1314:23 1367:4</p> <p>accurately [1] 1104:12</p>
--	---	--	--

REVISED AND CORRECTED TRANSCRIPT
OPEN SESSIONS

<p>acknowledge [2] 1195:6 1213:16 acquisition [1] 1299:3 acquisitions [1] 1296:9 across [4] 1209:7 1303:17 1318:23 1319:24 act [1] 1279:13 acted [2] 1275:20 1298:15 action [1] 1331:8 active [1] 1278:25 activity [2] 1212:25 1291:7 actors [1] 1089:4 actual [4] 1109:2 1248:8 1307:20 1327:25 actually [20] 1098:22 1099:15 1210:23 1221:11 1223:3 1247:17 1261:12 1283:1 1291:23 1294:20 1301:8 1306:10 1311:9 1312:19 1319:10 1324:21,23 1325:10 1326:11,13 actuals [1] 1331:14 ad-supported [7] 1204:10,13 1205:8 1206:10,12 1222:24 1223:14 adam [2] 1090:13 1276:18 add [2] 1103:23 1221:2 1292:15 1294:2 1296:19 1299:6 1318:21 1322:10 added [1] 1193:3 adding [2] 1292:18,20 addition [3] 1227:6,9 1258:6 additional [7] 1194:2 1214:4 1240:16 1261:6 1278:2 1316:2 1326:1 address [2] 1238:15 1243:22 addressed [1] 1304:19 addresses [2] 1208:17 1248:11 adjunct [1] 1093:25 adjust [7] 1219:22 1236:8 1239:4 1240:20 1307:18 1310:15 1313:19 adjusted [4] 1307:21 1310:2,10,12 adjusting [2] 1232:18 1309:16 adjustment [24] 1106:13,16 1214:2,15,17 1215:2,8,18 1216:5,24 1217:1,12,20,24 1218:1,11,14,25 1219:3 1237:2 1240:12,16,21 1308:17 adjustments [14] 1197:7 1213:20 1214:2,4,5 1215:4 1230:2,20 1231:3 1232:21 1234:13,22 1307:1 1310:22 administrative [1] 1094:4 administrator [1] 1294:1 admissibility [2] 1278:2 1329:13 admissible [1] 1277:14 admission [1] 1328:3 admit [2] 1304:7 1329:22 admitted [9] 1207:14 1209:18 1277:13 1278:7 1303:24 1304:10 1327:10 1331:12,17 adopting [2] 1104:22 1195:7</p>	<p>adoption [1] 1214:9 ads [2] 1250:12,12 advance [1] 1331:10 advantage [1] 1097:19 adverse [2] 1275:18,19 advertise [1] 1294:25 advertising [1] 1296:12 advised [1] 1202:1 advocacy [2] 1275:11,13 aetna [2] 1094:12 1095:24 aetna/humana [1] 1095:18 affects [1] 1333:1 affiliate [2] 1295:20,23 affiliated [1] 1296:23 affiliates [1] 1295:21 affirmative [1] 1102:21 affirmatively [2] 1248:20,22 afternoon [2] 1225:3 1226:3,4 1276:16 1277:17 1285:19,20 1365:9 ago [2] 1193:7 1220:25 1245:15 1280:19 1294:10 agree [11] 1103:1,5 1105:21 1192:12 1194:24 1202:6 1228:2 1235:8 1236:22 1254:3,6 agreed [4] 1191:11 1202:3 1207:14,17 agreement [3] 1109:9 1251:7 1278:1 agreements [10] 1103:9 1104:19, 21 1105:19,24 1108:21 1220:16 1233:6,17 1254:4 ahead [4] 1257:11 1273:2 1316:15 1319:4 al [2] 1095:25 1100:9 alert [1] 1225:9 alex [1] 1089:11 algorithmic [1] 1192:8 allow [3] 1285:9 1291:7 1318:23 allowed [4] 1240:4 1279:16 1322:14,24 allows [1] 1313:15 almost [5] 1098:21 1240:8 1284:21 1299:19 1322:7 alone [2] 1283:3 1311:20 already [5] 1205:3 1304:9 1305:4 1328:25 1333:21 alternative [1] 1198:23 alternatives [3] 1215:24 1217:6,7 although [7] 1095:12 1103:25 1207:13 1226:21 1234:3 1238:7 1273:2 altogether [1] 1217:12 am/fm [2] 1202:13 1204:22,24 1206:4,23 1321:12 amend [1] 1225:12 amended [1] 1095:5 america [1] 1283:12 american [4] 1089:2,4,5 1273:15 americans [1] 1097:20</p>	<p>americas [1] 1283:11 among [4] 1103:18 1211:14,16 1295:17 amount [6] 1109:4 1195:13 1241:14 1307:23,24 1311:7 analyses [7] 1099:20,20 1101:12 1246:9,11 1310:8 1311:20 analysis [52] 1097:12,13 1098:15, 21 1099:11,17 1101:12,14,17,19, 20,21,24 1105:4,16 1195:20 1197:24 1199:2,3,4,9 1212:20 1224:2 1231:21 1232:4 1235:23 1237:8, 23 1238:18 1240:7,9,10 1247:10 1255:19 1262:9 1295:9,14,14,15, 25 1296:6,8,11 1298:4 1299:1 1305:13 1306:6 1311:19 1314:8, 12 1323:23 1327:5 analyst [1] 1315:9 analysts [1] 1315:11 analytic [1] 1313:15 analyze [1] 1311:9 analyzed [2] 1227:14 1323:13 analyzing [2] 1105:5 1315:12 anchor [1] 1313:5 anchored [1] 1282:11 and/or [1] 1246:14 anecdote [1] 1247:16 angeles [1] 1089:25 annual [2] 1233:8 1323:23 another [14] 1095:13 1098:9 1100:6 1108:15 1197:16 1224:12 1262:1 1277:3 1288:21 1311:25 1313:10 1320:3 1327:20 1333:4 answer [15] 1215:5 1224:4 1243:17 1244:22 1245:1,12,18 1246:22 1261:8,16 1275:15 1294:9 1308:23 1320:5,12 anti-steering [2] 1108:14,15,19 1273:10,18,21 anticipate [1] 1293:4 anticipating [1] 1227:5 anticompetitive [1] 1273:19 antitrust [4] 1094:15 1097:14 1100:8,12 anybody [1] 1097:11 anyway [1] 1277:13 apart [1] 1235:14 apologize [5] 1206:2 1210:7 1325:25 1328:10,12 app [2] 1193:7 1194:2 apparently [1] 1209:16 appeals [2] 1273:15,19 appear [5] 1199:23 1227:19 1247:20 1288:7 1329:1 appearance [3] 1095:9 1283:15, 17 appearances [2] 1090:1 1091:1 appearing [2] 1199:24 1226:10 appears [6] 1202:11 1205:19 1209:1 1234:19 1242:19 1325:10</p>	<p>appendix [2] 1100:5 1284:2,11 1285:23 1297:18 1325:9 apple [4] 1100:16,21 1237:9,10 applicable [2] 1219:21 1309:21 application [4] 1198:14 1199:18 1292:7 1310:20 applied [4] 1215:2 1289:23 1292:14 1307:1 apply [4] 1241:17,21,25 1311:5 applying [2] 1097:4 1306:11 appointments [1] 1287:6 appreciate [1] 1332:20 approach [20] 1231:22 1232:13 1233:21 1234:18 1235:3,18 1236:15 1238:22 1240:11,25 1241:7,10, 21,25 1242:8,9 1243:25 1244:1 1252:4 1262:9 approaches [7] 1104:11,12 1231:10 1241:16 1242:19 1244:18,18 approaching [2] 1259:22 1261:11 appropriate [18] 1191:7 1197:7 1213:21 1218:1 1220:15 1221:15 1222:4 1223:4 1229:3 1230:1,6 1231:5 1234:17 1249:19 1262:15 1311:10 1316:6 1328:1 approximate [1] 1260:19 approximately [2] 1255:12 1281:9 1289:5 1300:13 1301:5 april [1] 1088:22 arabia [1] 1283:7 arbitrage [1] 1299:3 area [1] 1281:19 aren't [1] 1253:1 arent [2] 1091:6,12 argo [1] 1230:11 arguably's [1] 1212:17 argue [3] 1099:9 1277:2 1328:24 argument [2] 1198:10 1329:10 arguments [1] 1329:15 around [3] 1228:5 1276:4 1301:9 arpu [3] 1241:13,22,23 arrive [2] 1309:14 1329:15 article [3] 1281:15 1298:18 1299:13 articles [1] 1281:5 articulate [1] 1104:24 articulated [2] 1195:1 1261:18 artificially [1] 1314:9 artist [2] 1257:17,18 artists [2] 1089:5 1257:16 ascertain [1] 1231:18 ascertained [1] 1193:1 ascertainment [1] 1219:5 aside [1] 1308:9 asks [1] 1291:4 aspect [2] 1098:9 1101:22 aspects [1] 1313:18 assert [2] 1107:16 1108:5 1192:3 1201:9 1328:24 1332:11 asserted [1] 1100:16</p>
--	--	---	--

REVISED AND CORRECTED TRANSCRIPT
OPEN SESSIONS

<p>assertion [1] 1210:17 assess [3] 1290:6 1315:4 1321:3 assessing [1] 1323:16 assessment [1] 1332:16 assets [3] 1315:5 1321:25,25 assigned [1] 1300:21 assignment [1] 1311:8 assistant [1] 1287:11 associated [7] 1205:14 1207:22 1252:3,4,24 1253:18 1295:10 association [1] 1089:5 assume [4] 1097:21 1216:18 1220: 24 1225:20 assumed [1] 1099:13 assumes [1] 1097:16 assuming [4] 1219:18 1222:12 1224:11 1225:8 assumption [4] 1105:14 1196:18 1232:9 1259:16 assumptions [1] 1102:3 attempt [2] 1240:12 1328:24 attempted [5] 1217:1 1233:12 1293:6 1307:5 1311:1 attempting [1] 1252:19 attended [1] 1286:7 attention [11] 1233:4 1282:9 1283: 23 1284:2 1301:17 1304:17 1307: 9 1314:19 1323:25 1325:8,8 attorneys [1] 1277:23 attractive [1] 1319:11 attributes [1] 1096:18 audio [4] 1201:20 1203:10 1204: 25 1208:15 audit [1] 1299:10 auditor [1] 1299:10 austin [1] 1089:23 authenticity [2] 1328:25 1329:25 available [9] 1190:5 1193:8 1207: 15 1222:18,20 1237:13 1240:17, 18 1247:12 avenue [3] 1088:20 1089:17 1090: 9 average [4] 1239:21 1241:10,14 1315:14 avoid [4] 1248:22 1251:18,25 1253: 9 avoiding [1] 1221:18 aware [15] 1095:19 1108:1 1207: 20 1226:8,22 1235:16 1236:3,13, 23 1237:24 1243:2 1247:10 1255: 15 1258:5 1302:23 away [3] 1194:8 1196:24 1212:3</p> <p style="text-align: center;">B</p> <p>b-1 [2] 1325:10,12 bachelor [1] 1286:4 back [14] 1093:20 1107:25 1196: 18 1231:17 1240:25,25 1284:3 1287:10 1289:18 1290:15,19,20 1306:5 1318:10</p>	<p>background [5] 1107:12 1278:19 1288:12 1294:8 1312:24 bad [2] 1230:9,11 ballet [2] 1296:19,21 barnett [57] 1088:14 1092:3,10,16, 20 1109:10 1201:22 1202:5,7 1207:16 1209:18 1211:5 1224:9, 13 1225:3,10,18,24 1243:18 1244: 7,10,20 1245:17,20 1262:21 1273: 4 1275:1,24 1276:5,9,15 1277:7, 11,16 1278:6 1285:15 1297:11 1302:13,17 1303:5 1304:5,13 1324:4,9,15,20,24 1325:5 1326:16 1330:16 1331:11 1332:1,17 1333: 3,9,16,19 base [5] 1106:8 1286:11,21 1292: 12 1323:19 based [9] 1104:17 1195:17 1213: 23 1215:19 1232:3 1307:23 1308: 16 1309:2 1310:7 baseline [1] 1307:16 bases [2] 1102:18 1106:21 basic [3] 1282:16 1291:20 1292:5 basically [1] 1235:5 basics [1] 1323:5 basis [4] 1217:25 1226:18 1246:2, 6 basket [2] 1307:23,24 bates [5] 1096:5 1208:3,8 1209:23 1329:6 bear [1] 1329:6 bearing [1] 1208:3 beats [3] 1322:1,6,9 beauty [2] 1306:9 1310:19 become [5] 1107:17 1108:6 1192: 13,17 1294:11 becoming [2] 1200:25 1320:21 beg [1] 1208:7 began [3] 1094:21 1280:11 1287: 10 begin [1] 1235:22 beginning [3] 1094:22 1096:1 1228:7 begins [1] 1276:21 behalf [9] 1089:2,20 1090:2 1091: 2 1094:12 1096:21 1098:25 1226: 10 1276:18 behavior [3] 1194:15 1282:9 1283: 4 behavioral [18] 1279:23,24 1280: 16 1281:18 1282:15 1285:3 1290: 11 1293:7,10,16 1294:11,16,21 1301:19 1302:11 1303:2 1312:24, 24 behind [2] 1222:19 1232:25 beliefs [1] 1310:8 believe [33] 1093:15 1094:8,16,24 1095:12 1096:2 1104:9,15 1107:2 1191:10 1200:2 1201:21 1202:2, 12,16 1209:5 1214:1,23 1216:2</p>	<p>1225:6 1230:2 1242:24 1243:6 1248:2,4,9 1258:13,22 1273:15,25 1277:5 1309:22 1324:11 believed [1] 1310:24 believes [1] 1257:16 below [3] 1196:20 1240:24 1317: 11 benchmark [41] 1103:8 1106:15 1190:5,25 1191:7 1214:6,16,23 1215:4 1218:4,8,18 1219:19 1226: 5,10,16,24 1227:4,14,18 1229:3, 10,25 1230:6,10,16,16,20,22,25 1231:1 1232:17 1235:22 1237:17 1238:5,19,20 1246:17 1256:23 1258:2 1262:12 benchmarks [5] 1191:3,18 1229: 9 1230:9 1262:12 beneath [1] 1211:14 benefit [2] 1194:3 1239:1 benefits [2] 1216:13 1294:1 bern [2] 1278:21 1286:4 besides [2] 1280:2 1301:1 best [3] 1190:5 1230:11 1367:4 betrays [1] 1244:17 better [7] 1190:25 1230:8 1253:3, 20 1280:20 1319:8,22 between [35] 1098:11 1099:6 1103:10,18 1190:13 1197:4,5 1198:12,18 1199:7,10,16 1200:11 1201:4 1204:9,13 1214:6,15 1216: 7,21 1223:9,14 1231:10 1235:1,1, 7 1241:15 1242:5 1246:10 1252: 16 1254:13,22 1279:4 1286:4 1317:5 beyond [5] 1214:4 1227:3 1232:22 1234:13 1240:4 big [4] 1197:18 1219:10 1237:9 1305:11 binder [16] 1201:21 1207:1,4,6 1212:3 1232:23,24,24 1242:23 1283:24 1284:4,5,7 1324:1,1 1326:8 binding [2] 1223:18,25 bio [1] 1295:25 birnbaum [1] 1089:14 bit [5] 1277:24 1281:19 1302:1 1317:11,12 blank [1] 1105:18 block [5] 1089:16 1096:15 1274: 12 1275:10 1277:23 board [2] 1300:24 1301:2 body [1] 1103:9 boedeker's [1] 1232:7 boil [1] 1102:24 book [6] 1100:17 1280:18 1294:25 1295:1,2,5 books [2] 1100:8 1284:17 bore [1] 1098:10 both [22] 1098:23 1099:1 1108:23 1190:19 1191:12 1192:11 1203:</p>	<p>11 1218:23 1222:23 1233:15 1243:4 1247:3 1248:15 1253:13 1274:17 1283:7,11,11 1294:21 1296:23 1302:4 1315:24 bottom [4] 1100:7 1205:14 1233:5 1241:15 brand [1] 1203:15 break [3] 1224:6 1276:6 1333:4 breaking [1] 1224:9 breakout [1] 1324:15 brief [3] 1209:9 1262:19 1302:16 briefly [4] 1280:10 1302:14 1305:1 1325:24 bring [2] 1193:10,16 bringing [2] 1194:4 1312:13 broad [1] 1332:10 broadcast [1] 1324:6 broadcasting [2] 1315:24 1316:1 broader [1] 1211:21 broadly [2] 1104:10 1229:14 Broadway [1] 1091:7 bruce [1] 1090:3 brunner [3] 1298:5,9,12 brynteson [2] 1088:25 1367:9 budget [2] 1327:15 1331:13 budgets [4] 1323:23 1326:21,23 1329:11 building [1] 1088:19 bulk [1] 1304:3 bullet [3] 1220:19 1221:25 1223: 16 bullets [1] 1100:7 business [16] 1107:23 1108:16 1195:23 1196:2 1252:22 1254:7 1255:2,6 1257:11,12 1281:13,15 1282:3 1291:19 1314:1 1319:13 businesspeople [1] 1255:5 buy [2] 1198:5 1294:25 buyer/willing [3] 1219:12 1260:19 1261:1</p> <p style="text-align: center;">C</p> <p>c-4 [1] 1303:18 ca [1] 1089:25 cable [1] 1324:10 calculate [3] 1223:20 1307:5 1311: 2 calculated [3] 1196:13 1235:10 1309:10 calculation [4] 1194:25 1211:23 1216:25 1309:15 call [7] 1217:11,25 1228:4 1229:20 1242:22 1243:5 1276:3 called [5] 1092:13 1243:12 1251: 19 1294:20 1295:20 came [4] 1212:15 1234:25 1306:3 1307:2 campaign [1] 1296:12 canada [1] 1089:3 candidly [1] 1330:14</p>
---	--	--	---

REVISED AND CORRECTED TRANSCRIPT

OPEN SESSIONS

capacity [1] 1094:2 captive [2] 1213:5,6 capture [1] 1102:20 car [10] 1201:12 1202:23 1203:20 1204:20,23,24 1205:12 1206:23 1208:10,13,15 1210:3,12,24 1211: 13 1213:4,8 1259:18 card [9] 1247:15,18,21,24 1248:2,4, 6,9 1257:3 career [1] 1279:20 carry [1] 1096:18 cars [3] 1106:5 1204:17 1206:20 cart [1] 1257:11 case [32] 1094:16 1095:11,12,23 1096:9 1097:18 1100:12 1106:7, 10 1107:2 1214:8 1217:17 1221: 16 1222:12 1223:23 1229:8 1231: 19 1240:2 1243:4 1255:16 1273: 12,14,18 1274:1,7,9,16 1275:7 1283:21 1299:3 1309:4 1328:13 cases [10] 1230:17 1247:24 1273: 11,13 1274:4 1284:18 1301:9,12, 16,24 cash [9] 1315:6,6,7 1322:8 1323:1, 21 category [9] 1205:20 1206:12 1250:19 1279:8 1291:12 1321:15 1324:6,21,23 causation [1] 1252:20 cause [1] 1313:25 cautions [1] 1236:20 caveat [7] 1210:25 1211:24 1212: 1 1221:2,8 1222:17 1235:9 cbs [1] 1325:15 cd [2] 1205:2,3 cell [1] 1208:14 cents [9] 1253:8,9,15 1259:4,10 1317:14 certain [9] 1101:2,2 1106:21 1193: 6,6,10 1207:9 1274:4 certainly [1] 1329:14 certificate [1] 1367:1 certify [1] 1367:3 cetera [9] 1246:13 1284:17 1291:9 1292:7 1301:10 cetera's [1] 1212:18 chairperson [1] 1279:14 chairpersons [1] 1279:17 chairs [1] 1276:4 challenge [1] 1094:13 chance [2] 1326:13 1333:6 change [7] 1192:19 1194:21 1196: 3 1217:19 1233:24 1258:5 1319: 18 changed [7] 1105:15,17 1192:22 1197:11 1312:2,22 1313:12 changes [9] 1193:1,8 1194:7 1240: 21 1299:11 1305:7 channels [2] 1198:23 1312:21 characteristics [1] 1260:17	characterization [4] 1104:6 1200: 20,21 1210:19 characterize [1] 1241:11 characterized [3] 1101:7 1214:18 1235:20 characterizing [1] 1102:13 charge [2] 1198:4 1320:24 chart [2] 1204:2,3 check [1] 1324:11 chicago [1] 1280:4 choice [2] 1091:2 1213:7 choose [5] 1203:23 1204:24 1206: 4 1257:2,3 chose [2] 1286:18 1315:2 chosen [1] 1316:3 churchill [1] 1230:12 circuit [2] 1273:24,25 circular [1] 1099:13 circumstance [7] 1218:2,11,20, 23 1221:13 1254:19 1255:9 circumstances [1] 1223:12 cite [7] 1095:25 1108:7 1199:5 1201:15 1208:24 1221:25 1248:8 cited [1] 1100:1 claim [4] 1191:17 1201:15 1202:21 1210:15 claiming [1] 1191:16 claims [2] 1100:16 1210:1 clarity [1] 1221:8 class [4] 1286:13,14 1292:3 1294: 20 classes [1] 1279:22 classical [2] 1191:6 1282:17 classifications [1] 1315:21 cleaned [1] 1225:16 clear [5] 1094:20 1206:22 1209:8 1320:10 1322:11 click [9] 1288:20 1289:12 1290:19, 20 1293:10 clicked [1] 1289:25 close [9] 1109:10 1318:17 1320:18 1323:7 1332:21 1333:12 closer [3] 1193:11 1194:5 1210:22 cloth [1] 1244:14 club [1] 1293:24 cluster [1] 1233:10 coarser [1] 1315:23 code [1] 1301:21 coincidence [1] 1244:17 collaborate [1] 1282:4 colleague [3] 1209:7 1228:10 1294:19 colleagues [2] 1293:13 1302:14 collect [2] 1253:23 1257:2 collected [3] 1298:5,8,14 colloquially [1] 1100:11 columbia [1] 1096:3 column [9] 1233:5 1307:19,19,21, 22 1315:14 1321:18,19 combination [1] 1295:2	combine [1] 1283:2 come [9] 1199:8 1223:6 1235:2 1262:9 1293:3 1301:16 comes [3] 1242:3 1273:14 1282: 15 coming [9] 1196:18 1216:10 1232: 19 1235:24 1309:21 1332:15 comments [1] 1199:6 commit [3] 1108:25 1236:11 1242: 17 committed [1] 1102:16 committee [1] 1279:18 commonality [2] 1254:21,22 companies [19] 1094:14 1096:17, 22 1099:6 1103:10,18 1107:20 1292:11 1314:17 1315:18 1318: 24 1319:24 1321:8,19,25 1322:4 1324:23 1325:11,15 company [15] 1315:4,12 1317:5 1318:25 1319:1,6,7,9,12,13,20,22 1320:2,21 1322:14 company's [3] 1318:18 1320:19 1321:3 comparabilities [1] 1246:10 comparability [9] 1190:6,24 1246: 12 comparable [3] 1230:18 1235:22 1314:17 comparators [1] 1240:13 compare [5] 1318:23 1319:24 1320:2 1321:24 1322:4 compared [5] 1212:14 1215:21 1246:20 1249:13,15 comparing [1] 1216:17 comparison [4] 1238:20 1251:11 1310:7 1325:1 compensate [1] 1106:13 compensated [1] 1257:25 compete [2] 1197:21 1321:11 competition [32] 1096:10 1097:13 1099:6 1102:8 1103:4,18 1106:22 1107:20 1108:1,8 1191:15 1198: 15,18,20 1199:7 1200:11 1201:4 1213:18 1214:12,20,25 1216:21 1218:21 1219:1,3,14,17,20,23 1260:18 1261:10 1280:13 competitive [19] 1104:3,5 1106: 14 1107:18 1108:7 1199:20 1213: 24 1214:15 1215:9,13 1216:8 1217:3 1218:9,10,13,24 1260:15 1261:15 1322:19 complementary [1] 1103:16 complete [1] 1103:17 completely [2] 1195:5 1252:24 completing [1] 1289:12 compliant [1] 1104:17 components [1] 1101:16 compute [1] 1309:19 computed [1] 1307:17 concentration [1] 1098:12	concept [3] 1104:10 1200:24 1201: 2 conception [1] 1191:14 concern [1] 1332:8 concerned [1] 1253:19 concerning [2] 1245:23 1300:11 concerns [2] 1217:18 1254:23 conclude [5] 1106:12 1214:24 1218:14 1229:1 1314:3 concluded [4] 1104:3 1236:4,14 1314:4 conclusion [2] 1099:14 1212:21 conclusions [2] 1207:9 1323:4 condition [1] 1196:21 conditions [13] 1103:17 1104:3, 19 1105:5,11,15,25 1106:14 1199: 21 1230:23 1260:15 1261:15 1315:20 conduct [1] 1285:15 conducted [3] 1224:3 1247:10 1287:22 conduit [1] 1330:10 confidential [5] 1109:13 1210:4 1262:25 1333:23 1365:11 confirm [2] 1199:25 1232:12 confirms [1] 1243:23 confronted [1] 1256:21 confused [1] 1205:21 congress [2] 1088:2,18 connected [2] 1106:5 1208:15 consequences [1] 1302:2 conservative [3] 1232:8 1234:4 1322:12 consider [4] 1190:4 1315:11 1316: 9 1323:15 consideration [3] 1195:19,22 1244:3 considered [10] 1223:3 1229:21, 22 1234:21,22 1254:4 1316:6 1329:4,11 1332:14 considering [5] 1213:24 1236:25 1237:2,3 1246:17 considers [1] 1321:11 consistency [1] 1242:4 consistent [17] 1200:14,24 1201: 7,13 1213:8 1214:19 1218:24 1238:1 1243:24 1246:16 1252:8, 16 1256:23 1257:7 1258:1,1 1260: 17 constant [1] 1252:7 consult [1] 1302:14 consultant [1] 1275:20 consulted [1] 1275:19 consulting [10] 1094:2 1228:10 1291:1,6,8 1292:24 1295:9,16,18 1296:24 consumer [12] 1193:17,22,25 1194:3,4,11 1203:25 1213:1 1240: 8,16 1248:7 1309:18 consumers [14] 1193:16 1194:12,
---	--	--	--

REVISED AND CORRECTED TRANSCRIPT

OPEN SESSIONS

<p>14,17,18,19 1204:16,24 1205:12 1206:3,18 1213:5 1241:20 1254:16 contact [1] 1247:14 contacting [1] 1248:6 contains [1] 1284:7 contend [1] 1212:5 content [1] 1190:14 1192:25,25 1232:18 1233:15 1234:1 1260:3 context [3] 1253:12 1315:17 1323:4 continue [2] 1248:21 1250:2 continued [2] 1090:1 1091:1 continuing [1] 1233:5 contract [1] 1104:18 1220:17 1221:9,14,21 1222:3,13 1251:10 contradicts [1] 1243:11 contrary [1] 1222:5 contrast [1] 1108:21 contribution [23] 1240:7 1316:10, 13,17,19,22 1317:3,4,11,16,20,24 1318:8,14,19 1319:6,7,9,20,23 1320:13,19 1321:2 contributions [1] 1233:25 control [2] 1280:13 1315:19 convenient [1] 1224:6 converged [1] 1192:4 convergence [7] 1106:5 1190:3 1193:19,20 1200:14 1201:8,14 conversation [2] 1107:23 1228:6 conversely [1] 1218:12 conversion [7] 1247:6,9 1249:10, 14 1255:25 1256:16,18 convert [3] 1249:11 1250:25 1306:18 convey [1] 1244:13 copy [3] 1242:24 1284:19 1303:11 copyright [2] 1088:1 1300:24 core [2] 1280:20 1291:19 corners [1] 1233:2 corporate [1] 1280:17 correct [211] 1093:4,5,7,8,11,13,24 1094:1,5 1095:21,22 1096:7,20,24, 25 1097:3 1098:13,14,18,19 1099: 7,20 1100:1,9,10,13,15,19,23 1101:9 1102:5,10 1103:4,12,20,22 1105:25 1106:1 1107:1,8,12,13 1108:3,4 1190:8,21 1191:25 1192: 9,10,14,15,18,22 1193:21 1194:10, 17,23 1195:9 1198:14,20,21 1199: 11,12,19 1200:8,9,19 1201:12,16, 17 1202:15,16,18,24 1203:2,6,8 1204:4,5,19,23,25 1205:1,13,20, 22 1206:11,14,20,24 1207:3 1208: 15,18,19,23 1210:3,9,14,19 1211: 20,22 1212:2,19 1213:12,14,21 1214:3,7 1215:2,22 1216:10 1217: 3 1218:5,15 1220:18,23 1221:22 1225:13 1227:21 1228:1,12,13,15, 17,18 1230:7 1231:12,13,19,20</p>	<p>1232:15,20 1233:21,22 1234:9,19 1236:1,21 1237:19,20 1238:16,17, 25 1239:8,9,14 1240:5,6,14,15 1241:5,12,17,18,23,24 1242:2,3, 16,17 1246:4,5 1249:25 1250:4,6, 8,16 1251:2,3,13,14 1255:14 1258: 8,9,12,20 1259:6,12,19,20,25 1260:1,5,10,11 1261:22 1275:12, 19,20,21 1281:4 1286:2,9 1287:13, 16 1288:10,14,19 1299:25 1300:1, 9 1308:6,7 1309:5,7 1321:8,9 1324:8,10 1327:3 1333:17 correction [1] 1328:11 correctly [4] 1220:22 1290:9 1322: 24 1329:17 cost [10] 1195:15 1205:13,15 1254: 3 1317:19 1319:13,14,14,15 1323: 19 costly [1] 1299:2 costs [3] 1253:13,18 1282:10 1317:6,8,15 cote [1] 1101:5 couldn't [2] 1275:17 1331:9 counsel [15] 1228:4,21 1275:8 1276:25 1277:20,25 1285:22 1292:22 1293:6 1297:18 1324:5 1327:23 1329:10,16 1332:11 count [1] 1283:22 counted [1] 1289:4 couple [3] 1093:14 1225:15,22 1229:22 1242:19 1273:7 1287:8 1298:3 coupled [1] 1329:5 course [10] 1203:18 1279:20 1282: 21,22 1292:2 1299:14 1300:4 1312:11 1318:16 1323:23 1327:5 1329:14 1331:8 1332:8,11,24 courses [2] 1288:13 1292:1 court [21] 1094:3 1095:20 1096:3, 8,19 1097:7 1098:16 1099:4,21 1101:5 1225:9 1237:23 1244:2 1273:15,16,17,19,20 1275:10 1283:16 1367:10 courtroom [3] 1209:8 1323:8 1332:21 cover [3] 1304:22 1317:14,19 covering [1] 1258:11 cpi [3] 1307:18,20,23 cranked [2] 1314:14 1322:13 crb [1] 1301:1 create [2] 1252:20 1317:15 created [2] 1255:7 1332:13 credible [1] 1207:25 credit [9] 1247:14,18,21,24 1248:2, 4,6,9 1257:2 credited [1] 1309:3 criticized [3] 1101:16,20,22 critique [1] 1237:17 critiques [1] 1227:18 cross [1] 1365:2</p>	<p>cross-elasticities [1] 1199:13 cross-elasticity [3] 1198:12 1199: 10,16 cross-examination [4] 1092:8,24 1285:12 1330:23 crr [1] 1088:25 cum [1] 1286:6 current [22] 1095:13 1103:9 1104: 20 1105:5,10,25 1195:2 1197:2,3, 6,13,15 1223:17 1232:7 1236:16 1238:6,14 1246:23 1255:7 1257:5 1262:14 1302:21 currently [5] 1107:24 1195:8 1202: 22 1203:11 1259:3 curriculum [4] 1094:7 1284:15 1297:22 1302:20 customer [1] 1254:9 customers [2] 1322:15,25 customization [1] 1239:16 cut [2] 1231:24 1255:12 cv [5] 1095:13 1284:20,24 1285:22 1287:4</p> <p style="text-align: center;">D</p> <p>d.c [3] 1088:21 1089:18 1091:14 daily [2] 1239:20 1298:18 dancing [1] 1296:20 data [4] 1209:5 1210:25 1222:20 1321:3 date [2] 1237:14 1367:10 dated [1] 1105:24 daubert [1] 1100:25 david [2] 1088:16 1089:8 day [6] 1096:18 1217:7 1231:15 1240:1 1291:7 1299:22 days [4] 1248:4 1250:1,8 1257:14 deal [10] 1106:2,3 1108:25 1209:22 1219:11 1240:22 deals [2] 1108:14 1292:9 dealt [2] 1280:17 1302:2 dean's [1] 1291:4 decades [1] 1287:8 december [2] 1094:25 1095:4 decide [1] 1277:8 decided [3] 1237:7 1296:15 1316: 6 decision [25] 1093:7 1095:20 1096:8 1100:2 1102:12 1104:1 1105:8 1108:10 1197:19 1203:21 1221:25 1222:3,6 1226:20 1231: 17 1232:25 1236:24 1238:3 1256: 25 1257:6,7 1275:8,19 1305:5 1319:16 decision-making [1] 1223:5 decisions [2] 1105:14 1108:16 deck [3] 1220:12 1232:12 1276:4 declarations [1] 1100:22 decline [1] 1318:19 declined [2] 1235:7,12 decrease [1] 1196:1</p>	<p>defense [2] 1275:8,9 defer [6] 1104:1 1105:9 1197:23 1222:8 1255:5 1273:16 define [2] 1291:16 1317:2 defined [1] 1098:1 definition [3] 1097:2 1098:17 1254:11 degree [12] 1108:1 1198:20 1199: 6 1206:19 1214:24 1231:10,18 1235:14 1261:10 1278:20 1286:3 1294:22 deliver [1] 1190:14 delivered [1] 1212:7 demand [6] 1194:12 1198:12 1199: 10,16 1282:25 1322:22 democracy [1] 1230:13 demonstrate [2] 1200:10 1201:3 demonstrated [2] 1099:13 1223: 25 demonstrates [1] 1223:17 demonstrating [1] 1099:12 demonstrative [1] 1277:12 department [1] 1287:21 departure [1] 1196:4 dependence [1] 1313:2 dependent [1] 1238:18 depending [3] 1250:12 1251:7 1322:22 depends [1] 1247:23 depict [1] 1307:14 depiction [1] 1204:9 deposed [1] 1283:20 deposition [9] 1095:11 1212:23 1227:11,17 1231:15 1242:14,15 1261:5,13 depot [4] 1274:7,11,14,18 derived [2] 1308:4,9 describe [4] 1194:7 1230:5 1239: 5 1242:20 described [7] 1195:3 1206:5 1220: 1 1233:23 1237:3,8 1249:3 description [2] 1103:21 1190:9 design [1] 1299:15 designated [2] 1202:2,4 designation [1] 1286:23 desire [2] 1251:25 1285:11 despite [2] 1314:20 1328:17 detail [4] 1097:11 1206:16 1258: 21 1312:12 detailed [4] 1105:16 1197:24 1199: 2 1212:20 details [1] 1314:6 detected [1] 1092:5 determination [7] 1088:6 1216: 12,13 1221:20 1308:1,11,12 determine [2] 1213:21,23 determined [6] 1096:8 1197:17 1233:7 1254:7 1309:17 1310:5 determines [1] 1195:20 deterred [1] 1236:20</p>
--	---	--	--

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OPEN SESSIONS

<p>developed [3] 1282:5 1294:18 1308:20</p> <p>devi [1] 1089:13</p> <p>deviate [3] 1281:25 1282:8,16</p> <p>dial [1] 1207:2</p> <p>differ [2] 1218:5 1223:12</p> <p>difference [9] 1190:12 1216:21 1219:8 1223:9 1239:19 1241:15 1254:13 1279:4 1317:5</p> <p>differences [6] 1106:14 1216:7 1227:3 1230:21 1236:8 1249:16</p> <p>different [18] 1105:13 1197:9 1222:23 1223:7 1224:7 1234:12 1237:5 1242:19 1248:17 1250:10 1260:9 1279:15 1287:7 1289:5,23 1295:17 1296:22 1310:1</p> <p>differentiate [1] 1223:14</p> <p>differently [3] 1104:25 1209:8 1214:22</p> <p>differing [1] 1240:14</p> <p>difficulty [1] 1256:17</p> <p>dig [1] 1314:6</p> <p>digit [2] 1315:23 1316:2</p> <p>digital [2] 1205:5 1229:16</p> <p>digits [4] 1315:22,22,23,23</p> <p>dimension [3] 1292:14,19,20</p> <p>dimensions [2] 1190:7 1314:11</p> <p>dire [4] 1285:10,16,17 1365:6</p> <p>direct [54] 1095:5 1105:22 1107:16 1108:12 1190:10 1191:21 1195:3 1199:24 1202:10 1208:7 1210:15 1215:7,19,25 1216:4,14 1217:4,16 1225:13 1227:24 1228:6,8,22 1233:4 1235:17 1242:25 1246:1 1251:16 1260:12,13,14 1261:14 1276:20,25 1278:11 1283:23,25 1284:2,12 1285:25 1297:13,17 1304:8,17 1305:11 1307:9,11 1314:19,24 1323:25 1325:7,9 1330:20 1365:2</p> <p>directed [1] 1100:25</p> <p>directing [1] 1333:11</p> <p>direction [5] 1104:8 1194:20 1252:14 1312:22 1313:18</p> <p>directionally [2] 1103:22 1201:7</p> <p>directly [1] 1215:20</p> <p>disagree [2] 1099:15 1100:4</p> <p>disagreeing [1] 1214:22</p> <p>disappeared [1] 1277:22</p> <p>discipline [10] 1286:11,12,22 1289:14 1291:20 1292:5,12 1293:8 1299:7,8</p> <p>disciplines [1] 1288:24</p> <p>disclaimer [1] 1211:9</p> <p>disclosure [6] 1280:14 1292:9,20 1302:4,5,6</p> <p>discount [3] 1215:19 1216:18,20</p> <p>discuss [1] 1212:21</p> <p>discussed [5] 1213:17 1237:16 1239:10 1304:2 1305:4</p>	<p>discussing [2] 1195:24 1332:22</p> <p>discussion [7] 1099:16 1218:8 1223:8,8 1228:3 1236:24 1312:22</p> <p>discussions [4] 1200:3,4 1222:2 1227:25</p> <p>disentangling [1] 1197:11</p> <p>disparate [1] 1246:2</p> <p>disqualify [1] 1229:9</p> <p>disregarding [1] 1205:14</p> <p>disrupt [2] 1197:20,21</p> <p>disruptive [2] 1314:1,5</p> <p>dissertation [2] 1279:14,18</p> <p>distance [1] 1092:23</p> <p>distillations [1] 1106:11</p> <p>distinction [2] 1219:8 1292:22</p> <p>distinguish [2] 1204:9,13</p> <p>distinguished [1] 1287:19</p> <p>distortion [1] 1252:17</p> <p>distribute [3] 1190:22,23 1191:13</p> <p>distribution [1] 1191:1</p> <p>district [9] 1095:20 1096:2,3 1098:16 1101:5,6 1273:16,17,20</p> <p>dive [1] 1315:13</p> <p>diversion [1] 1199:14</p> <p>divided [2] 1311:15 1317:6</p> <p>document [15] 1109:3 1202:1 1206:25 1207:15 1208:24 1209:3,11,15,23 1211:2 1244:5 1248:8 1285:21 1329:22 1330:22</p> <p>documents [15] 1201:16 1207:5 1327:18,21 1328:1,3,6,17 1329:4,13,19,23 1330:22 1331:5 1332:12</p> <p>doing [5] 1109:1 1195:5 1239:21 1315:4 1323:10</p> <p>doj [1] 1098:5</p> <p>dollar [5] 1253:9 1305:7 1312:14 1317:8,14</p> <p>dollars [7] 1197:6 1259:22 1260:8 1307:7 1309:10,11 1310:2</p> <p>dominated [1] 1206:12</p> <p>dominates [2] 1202:13 1206:23</p> <p>done [22] 1093:14 1105:16 1197:24 1199:1,3,3,9 1212:20 1213:11,13 1215:14 1219:4 1226:14 1234:5 1246:18 1261:7 1273:3 1283:6 1294:3 1314:12 1324:17 1331:4</p> <p>doors [1] 1109:11</p> <p>double [3] 1194:22 1195:8,11</p> <p>doug [1] 1228:14</p> <p>down [9] 1102:24 1205:13 1257:12 1288:16 1289:15,19 1293:6,12 1318:20</p> <p>downloads [2] 1205:6 1229:16</p> <p>downstream [1] 1108:22</p> <p>dozen [2] 1262:1 1301:7</p> <p>dramatic [1] 1325:2</p> <p>drawn [1] 1104:18</p> <p>drew [2] 1207:9 1222:13</p> <p>drive [1] 1255:3</p> <p>driven [1] 1215:12</p>	<p>driving [2] 1194:14 1240:9</p> <p>dubai [1] 1283:7</p> <p>due [4] 1103:2 1190:6 1216:18 1329:14</p> <p>duly [2] 1092:14 1276:13</p> <p>during [2] 1093:18 1309:21</p> <p style="text-align: center;">E</p> <p>e-books [2] 1100:12,18</p> <p>e-mail [3] 1225:11 1247:17 1248:11</p> <p>e-reader [1] 1102:8</p> <p>each [14] 1200:5 1201:18 1212:12 1227:16 1259:4,22 1289:25 1307:17 1309:16 1317:7,13 1326:4,21 1327:12</p> <p>earlier [9] 1209:13 1227:8 1233:23 1237:2,8 1240:18 1299:1 1304:2 1333:4</p> <p>early [1] 1237:12</p> <p>ease [2] 1099:12 1256:17</p> <p>east [1] 1283:6</p> <p>ebin [3] 1090:6 1201:24 1256:6</p> <p>ebitda [3] 1315:5 1322:5 1323:1</p> <p>econ [1] 1286:15</p> <p>econometric [4] 1098:14 1101:12,19 1199:2</p> <p>econometrics [5] 1279:22 1289:24 1299:19,20 1300:15</p> <p>economic [23] 1096:23 1196:9 1218:17 1219:7 1220:20 1221:1,3,18 1222:16,20 1252:1 1253:2,5,21 1254:24,25 1255:7 1289:24 1294:15 1298:4 1300:15 1315:20 1332:15</p> <p>economics [8] 1093:4,10 1220:21 1221:4,5 1253:7 1278:20 1279:22,24 1280:20,21 1281:1,2,11,12,13,22 1282:6,18 1283:2 1285:3,3,7,14 1286:1,11,18,19,21,24 1287:1 1288:2 1289:20 1290:3,11,11,15,18,21,23 1291:17,20,23,24,25 1292:4,7,8,13,14,18,19,21 1293:7,10,16 1294:8 1295:3 1296:13 1298:11,22,23 1299:5,6,8,12,13,18,24,25 1300:3,7,11,12,14,20 1301:14,14,18,19 1302:7,11,12 1303:2,3 1312:25 1313:16 1314:7</p> <p>economist [2] 1096:14 1297:1</p> <p>economists [4] 1097:15 1226:9 1244:16 1315:3</p> <p>edison [3] 1207:2,20,24</p> <p>editor [4] 1280:22 1298:15 1300:6,12</p> <p>editorial [1] 1300:5</p> <p>editors [3] 1280:25 1300:16,17</p> <p>education [2] 1282:3 1302:25</p> <p>educational [1] 1278:18</p> <p>effect [4] 1102:7 1109:2 1216:3 1236:10</p>	<p>effective [24] 1103:4 1213:18 1214:20,25 1218:20,25 1219:3,14,17,19,23 1220:15 1221:11,12,16,17 1222:1,2,8,14 1231:23 1235:6 1238:23 1241:3</p> <p>effectively [8] 1104:5 1213:24 1214:14 1216:8 1218:9,10,13,23</p> <p>effects [1] 1096:23</p> <p>efficient [3] 1254:15 1257:1,8</p> <p>effort [1] 1096:16</p> <p>efforts [1] 1236:8</p> <p>eight [1] 1234:22</p> <p>either [11] 1107:24 1205:7 1214:16 1219:20 1231:17 1237:10,11 1261:21 1290:22,23 1315:22</p> <p>elasticity [1] 1322:22</p> <p>elderly [1] 1097:19</p> <p>electronic [1] 1100:8</p> <p>element [1] 1191:12</p> <p>elicit [1] 1209:5</p> <p>eliminating [1] 1217:12</p> <p>else's [1] 1216:13</p> <p>embarrassing [1] 1284:21</p> <p>emerged [1] 1108:9</p> <p>emerging [2] 1195:23 1196:2</p> <p>emeriti [1] 1279:16</p> <p>emeritus [6] 1278:16 1279:2,3,5,6,9</p> <p>emphasize [1] 1299:6</p> <p>empirical [5] 1199:9 1213:11 1217:16,25 1299:1</p> <p>empirically [1] 1213:14</p> <p>employ [1] 1106:16</p> <p>end [6] 1219:10 1250:7 1251:12 1260:7 1303:17 1316:20</p> <p>endeavor [1] 1097:24</p> <p>ended [2] 1248:20 1301:8</p> <p>ends [2] 1251:4 1317:12</p> <p>engage [3] 1107:20 1197:19 1299:2</p> <p>engaged [5] 1237:23 1252:12 1274:15,17,21</p> <p>engagement [1] 1094:21</p> <p>engaging [1] 1102:14</p> <p>englund [1] 1089:9</p> <p>enough [9] 1096:16 1104:2 1195:14 1308:23 1316:21 1317:18,21 1326:15,18</p> <p>enron [2] 1301:24 1302:2</p> <p>ensuing [1] 1095:20</p> <p>ensure [5] 1109:4 1219:16 1252:15 1253:3,6</p> <p>ensures [1] 1254:14</p> <p>ensuring [1] 1257:24</p> <p>enter [1] 1218:16</p> <p>entered [5] 1103:10 1104:21 1221:9 1237:10,11</p> <p>entertainment [3] 1089:20 1213:8 1291:12</p> <p>entice [1] 1254:9</p>
---	--	---	--

REVISED AND CORRECTED TRANSCRIPT
OPEN SESSIONS

entire [5] 1216:18 1221:24 1222:11 1286:14 1292:3	examination [17] 1092:13 1102:9 1209:6,9,14 1213:11 1246:18 1247:13 1248:10 1262:19 1273:5 1276:20 1277:1 1278:11 1285:17 1297:13 1330:21	1282:2	feature [1] 1308:2
entirely [2] 1094:11 1098:21	examine [4] 1106:20 1248:24 1249:18 1323:22	express [1] 1273:15	featured [1] 1103:16
entirety [1] 1248:5	examined [5] 1092:14 1247:2 1248:13 1276:13 1313:24	expressed [2] 1105:7 1311:3	feder [3] 1088:15 1211:11 1277:11
entities [1] 1308:18	examining [1] 1233:6	extended [1] 1331:4	federal [1] 1095:20
entitled [1] 1298:18	example [17] 1106:1 1107:5 1191:4,6 1193:5 1213:2 1222:21 1236:24 1238:11 1239:20 1248:1 1250:1 1259:7 1292:10 1317:13 1320:23 1327:13	extensive [1] 1223:7	federation [2] 1089:2,4
entity [1] 1207:20	exams [2] 1286:25 1291:24	extent [14] 1099:5 1105:12 1197:9 1200:2 1204:16 1215:11 1222:19 1227:2 1229:19 1246:22 1321:16 1328:21 1329:9 1332:14	fee [3] 1205:4 1216:15 1255:16
entries [1] 1298:3	exceeded [1] 1210:18	extrapolate [1] 1311:23	feed [1] 1225:11
entry [3] 1099:12 1294:4 1297:3	excellent [1] 1295:1	eyes [1] 1313:2	feel [1] 1102:24
equal [2] 1261:23 1311:3	except [1] 1108:11		feels [1] 1209:7
equally [1] 1107:7	exclude [1] 1191:17	F	few [5] 1207:5 1245:22 1283:9 1295:8 1297:10
equated [1] 1261:25	excluded [1] 1191:4	face [1] 1322:22	fewer [2] 1315:23 1319:17
equating [1] 1262:10	excuse [3] 1248:14 1321:25 1328:5	facie [1] 1096:9	field [17] 1093:12 1279:25 1280:8,16 1281:1,21,22 1285:6,14 1289:19 1290:3 1291:16,17,17 1292:20 1293:7,16
equivalence [1] 1198:10	excused [1] 1275:25	facing [1] 1204:22	fields [5] 1285:7 1289:8 1290:7 1291:19 1293:15 1303:2
equivalency [4] 1104:10 1105:20 1198:9 1199:18	executive [1] 1280:8	fact [32] 1106:4 1214:11 1226:19 1227:4 1228:9 1233:13 1235:5 1238:12 1240:13 1243:23 1244:1 1246:10 1257:18 1275:15,16 1287:1 1292:2 1300:2,10 1306:24 1322:16 1328:7,17 1329:3,5,14,18,19 1331:2,6,8,9	figure [3] 1089:24 1090:9 1289:15
equivalent [1] 1241:9	executives [5] 1107:11,14,19,23 1108:17 1327:24	factor [4] 1215:5 1218:7 1220:2 1281:2	fifth [5] 1307:11,14 1314:22,23 1324:5 1325:19
escalating [1] 1307:3	exercise [1] 1275:4	factors [21] 1099:3 1103:3 1195:21 1196:10 1212:22 1213:25 1214:19 1218:19,21,25 1219:4,6,13,16,21,25 1237:3 1258:1 1306:12 1308:6 1310:21	filed [2] 1094:17,23
esq [20] 1089:8,9,10,11,12,13,14,15,21,22 1090:3,4,5,6,7,13 1091:3,4,5,11	exhaustive [1] 1294:9	facts [3] 1101:23 1102:5 1106:6	final [3] 1208:24 1298:13 1328:18
essays [3] 1298:5,8,14	exhibit [19] 1201:19 1207:1 1209:1,18,19 1211:6 1243:4 1244:6 1278:8 1283:24 1303:11,24 1304:7,11 1326:6 1329:2 1331:18 1365:15 1366:1	faculty [10] 1288:17,22,23 1289:8,14 1290:2 1291:5 1292:24 1293:9,13	finance [23] 1278:22 1279:21,23 1280:12 1281:18 1285:7 1286:9,12,22 1287:3 1288:1 1291:22 1292:6,13,13 1293:15 1294:12,16,21 1296:7,8,25 1312:24
essence [3] 1102:20 1240:9 1242:6	exhibits [13] 1243:5 1278:2,3,4,7 1324:2 1325:23 1326:2,12,20 1327:9 1331:11 1333:12	fail [2] 1220:21 1221:3	financial [28] 1195:14 1196:21 1280:25 1281:12 1285:3 1289:12 1290:11,17,21,23 1291:17 1292:8 1294:8,15 1296:8 1299:5,18,23 1301:18 1302:11 1303:2 1314:10 1315:3,9,11 1323:6,16 1327:5
essentially [3] 1314:6 1317:7 1320:11	exist [1] 1286:18	failed [1] 1231:16	financially [1] 1323:10
established [4] 1096:9 1213:22 1310:16 1329:3	existing [1] 1238:14	fair [19] 1096:16 1102:17 1104:2,6,13 1190:9 1196:20 1213:1 1218:22 1220:3,3 1223:13 1261:13 1288:2 1307:10 1308:25 1320:1 1326:15,18	find [5] 1202:3 1230:9 1233:1 1235:19 1236:7 1330:16
establishing [1] 1331:24	expand [2] 1289:3,22	fairly [4] 1102:20,23 1257:25 1294:9	fine [2] 1242:22 1273:4
estate [2] 1292:6 1296:7	experience [5] 1095:10 1100:7 1246:19 1294:11 1296:5 1302:25	fairness [1] 1281:24	finish [1] 1319:4
estimate [2] 1217:17 1232:3	experiment [1] 1322:24	fakler [5] 1091:3 1092:17,19 1225:21,24	firm [5] 1212:21 1228:10 1274:15 1295:9,16,18
et [5] 1095:25 1100:9 1212:18 1246:13 1284:17 1291:9 1292:7 1301:10	expert [23] 1100:21,22 1204:1 1283:14 1285:2 1289:7,14 1290:2,10 1293:14 1296:6,13,21,25 1300:23,25 1301:6,13,18,23 1302:11,24 1331:3	fall [2] 1094:23 1238:14	firms [2] 1274:10 1295:22
etiology [1] 1298:4	expertise [1] 1290:6	fall-back [1] 1260:20	first [20] 1103:1 1196:5 1197:2 1201:19 1202:17 1220:19 1228:3 1231:15 1232:23 1247:15 1274:20 1276:13 1283:24 1289:2 1291:18 1305:3 1308:9 1314:22 1327:13 1332:3
europe [1] 1283:8	experts [5] 1098:23 1229:7 1288:17,23 1295:19,20	falling [2] 1250:19 1314:18	fit [2] 1099:24 1260:25
evaluate [2] 1313:10,15	explain [4] 1249:15 1290:22 1295:13 1314:21	familiar [5] 1101:4 1226:14 1302:20 1305:22 1306:1	five [3] 1276:24 1277:4 1300:17
evaluating [1] 1235:18	explained [4] 1235:5 1281:24 1294:7,14	familiarity [1] 1235:15	five-minute [1] 1276:6
even [12] 1231:14 1232:9 1250:5 1257:4 1281:14 1302:18 1308:20 1311:22 1317:19 1320:14 1323:2 1325:2	explaining [1] 1283:4	fantastic [2] 1323:11,16	fixed [5] 1317:8,15,19 1319:13,14
event [2] 1250:24 1331:22	explains [1] 1281:23	fapr [1] 1088:25	flip [1] 1202:17
events [1] 1252:22	explanation [1] 1320:9	far [5] 1191:12 1222:9 1225:8,22 1279:7	flow [4] 1315:6,6 1322:8 1323:1
everyone [2] 1288:7 1333:21	explicitly [2] 1273:20 1275:15	fascinating [3] 1249:6,17 1281:21	flows [2] 1315:7 1323:21
everything [3] 1094:8 1292:15 1322:19	exposed [3] 1221:24 1222:11	fashion [2] 1099:24 1288:12	focus [5] 1193:23,24 1239:22 1255:6 1312:2
evidence [36] 1104:20 1106:7 1108:7 1193:23 1209:15,20 1217:17 1223:17,24 1251:23 1255:23 1278:3,9 1299:10 1303:24 1304:12 1309:2,4 1312:6,7,8,9,10 1326:12 1327:10,21,21 1329:20,23 1330:3,13,17,20 1331:5,19 1332:13		faster [1] 1201:24	focused [1] 1227:17
evidenced [1] 1257:18		favor [1] 1098:17	focuses [1] 1105:4
evolved [3] 1104:20 1280:15,19			folks [2] 1100:11 1333:16
exact [1] 1103:9			
exactly [2] 1233:20 1256:20			
exam [2] 1286:16 1294:4			

REVISED AND CORRECTED TRANSCRIPT

OPEN SESSIONS

<p>follow [1] 1313:1</p> <p>following [5] 1102:20 1225:7 1293:20 1313:23 1326:24</p> <p>follows [2] 1092:15 1276:14</p> <p>fontaine [1] 1228:14</p> <p>foods [3] 1198:1,3,6</p> <p>footnote [1] 1252:10</p> <p>forces [1] 1214:12</p> <p>forcing [1] 1106:5</p> <p>ford [3] 1225:7 1246:14,14</p> <p>forecasts [1] 1332:22</p> <p>forego [1] 1253:8</p> <p>foregoing [1] 1367:3</p> <p>forgetting [1] 1234:6</p> <p>forgot [1] 1284:22</p> <p>form [4] 1108:8 1191:1 1211:17 1212:21</p> <p>formula [1] 1317:24</p> <p>formulating [1] 1227:23</p> <p>forth [4] 1102:21 1191:21 1232:17 1330:9</p> <p>forward [5] 1101:1,8 1106:9 1207:5 1217:21</p> <p>found [7] 1098:20 1099:4 1101:22 1103:15 1238:13 1273:11 1293:20</p> <p>foundation [5] 1235:21 1327:18 1328:2,21 1329:2,19,25 1330:24 1332:10</p> <p>four [5] 1100:7 1101:7 1199:23 1219:21 1300:17 1308:5 1315:22 1326:2</p> <p>fourth [3] 1221:25 1288:16 1305:13</p> <p>fox [2] 1091:6,12</p> <p>fraction [2] 1250:15,18</p> <p>frame [1] 1237:6</p> <p>framework [5] 1218:22 1219:12 1260:20 1261:1 1312:20 1313:9,12,15 1317:2</p> <p>frankly [2] 1208:6 1244:16</p> <p>free [30] 1102:24 1205:2 1245:23 1246:17 1247:19,22 1248:2,25 1249:23 1250:2,7,15,24 1251:1,8,12,13,14 1252:23 1255:3,11 1256:22,24,25 1257:13 1315:6 1322:8 1323:1,21 1324:10</p> <p>freedman [1] 1089:10</p> <p>freight [1] 1250:21</p> <p>fresh [1] 1313:2</p> <p>front [2] 1102:11 1275:14</p> <p>ftc [2] 1274:6,12</p> <p>fulfilling [1] 1298:16</p> <p>full [5] 1191:9 1200:2 1238:5 1250:21 1251:4 1255:2</p> <p>fully [1] 1203:12</p> <p>function [1] 1296:18</p> <p>functionality [5] 1192:8 1193:4,16 1194:2,13 1200:25 1240:4,14 1258:24</p>	<p>further [3] 1092:14 1220:7 1240:20 1275:22,24 1297:7 1302:9 1311:20</p> <p>future [3] 1284:9 1305:18 1332:22</p> <p style="text-align: center;">G</p> <p>game [2] 1282:6,16</p> <p>gamesmanship [3] 1251:20 1252:13,25</p> <p>gatekeeper [1] 1297:3</p> <p>gatekeeping [1] 1296:18</p> <p>gave [3] 1195:25 1213:2 1294:9</p> <p>gears [1] 1276:6</p> <p>general [5] 1103:21 1221:1 1226:13 1236:12 1301:2 1332:8</p> <p>generates [1] 1232:13</p> <p>gentleman [1] 1290:19</p> <p>gets [3] 1205:11 1257:13 1317:14</p> <p>getting [3] 1217:9 1316:15 1318:10</p> <p>give [11] 1100:3 1107:11 1202:25 1224:3 1245:12 1248:3 1260:6 1282:11 1312:15 1313:9 1333:5</p> <p>given [19] 1107:10 1195:11 1212:5 1217:18,18,19 1218:20 1239:21 1240:7 1244:2 1252:5 1257:23 1258:3 1259:13 1260:20 1275:16 1281:6 1320:2 1329:9</p> <p>gives [5] 1247:24 1248:1 1307:15,20,21</p> <p>giving [3] 1283:5 1313:11,14</p> <p>glean [1] 1229:18</p> <p>gleaned [1] 1106:6</p> <p>glimpse [1] 1306:10</p> <p>google [1] 1100:17</p> <p>got [5] 1207:7 1228:5 1247:17 1310:19,22</p> <p>gotshal [4] 1090:8,14 1274:18,21</p> <p>gotten [1] 1286:17</p> <p>govern [2] 1105:20 1223:12</p> <p>governing [1] 1221:12</p> <p>government [3] 1094:13 1096:8 1099:1</p> <p>government's [1] 1098:18</p> <p>graduate [1] 1292:1</p> <p>graduated [1] 1286:5</p> <p>granted [2] 1101:6 1225:20</p> <p>great [1] 1248:23</p> <p>greater [4] 1108:9 1212:6 1239:16 1312:12</p> <p>greater-of [3] 1262:2,5,13</p> <p>greek [1] 1305:17</p> <p>grew [1] 1323:19</p> <p>gross [4] 1233:8 1311:5,14,17</p> <p>ground [1] 1299:7</p> <p>grounds [2] 1094:15 1326:3</p> <p>group [10] 1089:6,7 1100:9 1295:9,14,15,25 1296:6,11,24</p> <p>grouped [1] 1315:18</p> <p>grouping-based [1] 1299:16</p>	<p>growing [2] 1201:10 1210:2</p> <p>growth [1] 1332:23</p> <p>guess [1] 1108:13</p> <p>guesswork [1] 1102:14</p> <p>guidance [1] 1244:15</p> <p>guide [1] 1288:17</p> <p>guidelines [2] 1098:6,8</p> <p>guild [1] 1089:4</p> <p style="text-align: center;">H</p> <p>half [9] 1224:12 1231:25 1233:17 1234:2,3,12 1235:2 1241:22 1255:12</p> <p>hand [5] 1092:6 1237:4,4 1276:10 1316:7</p> <p>handzo [21] 1089:8 1099:23 1109:7 1202:6 1207:17 1209:16 1225:5,14 1241:7 1243:1,10,16,18 1244:4 1245:20 1256:3 1273:2,6 1274:23 1276:2 1277:22</p> <p>happening [2] 1292:15 1297:6</p> <p>happens [1] 1253:6</p> <p>happy [3] 1097:12 1277:2 1285:10</p> <p>hard [2] 1280:19 1291:19</p> <p>harm [1] 1197:18</p> <p>harmonize [1] 1254:14</p> <p>harmonizing [1] 1254:25</p> <p>harvard [1] 1281:15</p> <p>hate [1] 1312:15</p> <p>head-to-head [1] 1099:6</p> <p>health [3] 1092:6 1094:14 1097:19</p> <p>healthy [1] 1320:12</p> <p>heard [1] 1329:15</p> <p>hearing [4] 1276:8 1278:6 1333:8,12</p> <p>heart [1] 1249:19</p> <p>hello [2] 1297:15,16</p> <p>help [2] 1323:4 1330:8</p> <p>helpful [2] 1099:21 1236:9</p> <p>high [7] 1093:20 1195:12 1198:11 1199:16 1282:25 1314:16 1319:14</p> <p>higher [10] 1194:1 1232:9 1234:25 1236:16 1238:13 1311:22 1312:1,11 1320:13 1323:2</p> <p>highest [4] 1260:7 1286:15 1292:3 1320:25</p> <p>highlighted [1] 1211:11</p> <p>himself [1] 1277:18</p> <p>history [1] 1093:4</p> <p>hit [2] 1254:8 1289:4</p> <p>hold [1] 1093:9</p> <p>holding [1] 1252:7</p> <p>holland [1] 1283:9</p> <p>honor [19] 1092:9,19,23 1109:7 1202:1 1211:4 1243:9 1274:25 1278:10 1285:5 1297:9 1303:4 1304:10 1327:12 1328:4,10 1330:25 1332:18 1333:18</p> <p>honorable [3] 1088:14,15,16</p>	<p>honors [18] 1207:12 1209:2 1224:5 1262:19 1276:16 1277:17 1284:22 1285:1 1294:24 1302:8 1303:23 1322:12 1326:10 1327:8 1328:23 1330:9 1331:20 1333:14</p> <p>honors' [1] 1095:23</p> <p>hope [3] 1284:22 1295:1 1304:23</p> <p>horizontal [2] 1098:6,7</p> <p>horse [1] 1257:12</p> <p>hour [3] 1224:12,14 1240:1</p> <p>hourly [1] 1239:19</p> <p>housekeeping [1] 1277:24</p> <p>however [2] 1105:21 1206:22</p> <p>hulfish [1] 1090:15</p> <p>human [1] 1283:4</p> <p>humana [1] 1094:12</p> <p>humor [1] 1291:15</p> <p>hybrid [1] 1291:17</p> <p>hypothesis [1] 1102:3</p> <p>hypothesizing [1] 1215:16</p> <p>hypothetical [7] 1097:5,8,15,16,21,22 1098:2</p> <p style="text-align: center;">I</p> <p>idea [7] 1212:9 1213:23 1234:13,20 1253:3 1257:15 1313:23</p> <p>identical [10] 1234:8 1236:20,22 1242:8 1244:1,18,24 1245:2,4,10</p> <p>identified [9] 1193:19 1241:2 1289:7,20 1290:1 1293:9,14 1296:25 1297:22</p> <p>identifies [3] 1288:11 1289:4,13</p> <p>identify [4] 1287:6 1288:22 1296:11 1326:16</p> <p>identifying [1] 1316:5</p> <p>iheart [5] 1104:22 1108:14 1203:10,14 1325:16</p> <p>ii [25] 1196:19,24 1197:10 1226:12,20,23 1227:14 1228:11 1231:12,17 1232:25 1235:8 1236:4,14,24 1237:6,18 1242:9,18,25 1243:3 1283:16 1306:3 1310:17,21</p> <p>iii [2] 1088:12 1283:18</p> <p>illuminated [1] 1222:7</p> <p>illustrative [1] 1277:13</p> <p>imagine [1] 1221:7</p> <p>immediate [1] 1195:6</p> <p>immediately [1] 1194:22</p> <p>impact [5] 1195:7 1276:24 1281:2 1308:5 1314:1</p> <p>impeach [3] 1243:17,20 1245:18</p> <p>impeachment [3] 1243:9,13 1244:4</p> <p>implement [1] 1104:12</p> <p>implemented [1] 1226:25</p> <p>implicit [1] 1252:20</p> <p>importance [1] 1312:19</p> <p>important [4] 1200:25 1315:10 1317:16 1330:18</p> <p>importantly [1] 1190:12</p>
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REVISED AND CORRECTED TRANSCRIPT
OPEN SESSIONS

<p>impose [1] 1197:18 impossible [1] 1310:23 improved [1] 1104:4 impulses [1] 1298:19 in-car [2] 1201:20 1202:13 in-person [1] 1095:15 inappropriately [1] 1202:4 inc [1] 1090:2 incentive [9] 1251:18 1252:2,8,14 1253:2,6,14,19 1254:12 incentives [7] 1252:5,6 1254:14, 24 1255:7 1257:8 1299:2 incidentally [1] 1299:18 include [3] 1215:24 1217:5 1285: 11 included [6] 1216:5 1293:23 1302: 4 1321:14 1325:11,15 includes [3] 1315:24 1321:7 1324: 6 including [9] 1104:21 1107:25 1199:5 1201:11 1259:23 1292:3 1296:7 1325:15 1331:22 income [3] 1220:4 1291:6 1292:24 inconsistent [1] 1196:10 incorrectly [1] 1098:3 increase [4] 1195:11,15 1255:24 1256:15 increased [5] 1103:19 1200:14 1201:7,13 1314:9 increasing [3] 1208:12 1256:18 1320:20 increasingly [10] 1104:5 1106:4 1107:18 1108:6 1192:4 1194:12 1200:25 1214:14 1281:18 1320: 21 incremental [1] 1205:4 incurred [1] 1253:13 indeed [2] 1217:10 1291:16 independence [1] 1088:20 independent [2] 1089:6 1252:22 index [1] 1309:18 indicate [2] 1242:14 1324:5 indicated [4] 1107:15 1213:10 1237:24 1241:8 indicia [1] 1329:8 indie [1] 1237:1 indies [1] 1238:21 individual [3] 1212:12 1247:24 1248:1 induce [1] 1108:8 industries [1] 1315:18 industry [1] 1107:1 inferior [1] 1229:9 infinite [1] 1207:2 inflation [5] 1307:18,20 1309:17 1310:10,12 influenced [3] 1108:16 1212:25 1281:5 information [1] 1330:8 information [30] 1094:18 1095:24</p>	<p>1098:24 1109:9 1195:13 1204:19 1207:25 1221:11 1229:16,19,23 1232:7 1237:13 1241:19 1247:11, 15,18 1248:7 1249:12 1256:16 1257:3 1262:22 1287:12,18 1289: 3 1299:2 1330:6,10 1333:1,20 informed [1] 1261:6 inquire [1] 1107:24 inquiring [1] 1108:2 insist [1] 1279:12 insofar [1] 1191:10 instead [2] 1250:22 1310:16 institutional [1] 1292:8 insurance [2] 1094:14 1097:19 integration [1] 1295:4 intellectual [1] 1230:17 intend [2] 1304:21 1318:13 intended [1] 1102:23 intends [1] 1330:13 intending [1] 1276:25 intent [2] 1222:9 1330:20 intentional [1] 1262:6 interactive [78] 1103:11,16 1104: 19 1106:22 1107:17,21 1108:5 1190:4,13,19,25 1191:13,23 1192: 3,7,13,18 1193:11,20 1194:5,8,9 1198:13,19 1199:7,11,14,17 1200: 12,19 1201:1,5,11 1203:7,12,15 1204:17 1208:21 1210:12 1212:8 1214:10 1217:2 1220:16 1223:18 1224:1 1226:8,24 1227:14 1229:1, 10,24 1231:24 1233:14,17 1235:7, 19 1236:5 1237:5,17 1238:4,24 1239:7 1241:4 1242:6 1246:3,16, 19,24 1247:7,11,20,21 1248:15 1249:14,23 1254:20 1256:23 1257:19 interactivity [3] 1194:8,17 1240: 20 interest [3] 1254:21,22 1257:24 interested [2] 1281:18 1291:14 interests [1] 1212:22 interject [1] 1290:8 intermediate [1] 1310:20 internet [7] 1200:18 1205:18 1206: 19 1208:13,17,22 1212:7 interpret [1] 1332:10 interrupt [2] 1251:5 1276:17 interviewed [1] 1107:13 intimately [1] 1226:14 introduce [3] 1277:18,19 1278:13 introducing [1] 1218:18 introduction [1] 1310:18 intrude [1] 1209:6 intrusion [1] 1326:1 invented [2] 1244:13 1279:8 invest [1] 1319:2 investments [1] 1315:7 investors [4] 1292:9,11 1302:3,5 invite [1] 1232:11</p>	<p>inviting [1] 1102:14 involve [5] 1218:19 1298:11,23 1299:13 1300:3 involved [9] 1100:15 1107:6,7 1284:18 1293:22 1300:14 involves [1] 1300:16 involving [3] 1260:16 1261:17 1301:24 ipsos [1] 1201:20 irrelevant [1] 1282:12 irrespective [1] 1214:23 isn't [3] 1192:22 1242:10 1245:4 israel [1] 1283:7 issue [20] 1098:15 1099:17 1197: 23,25 1205:13 1207:13 1212:21 1213:11 1216:4 1222:25 1234:10 1237:1 1246:17 1247:2 1248:9,13, 24 1254:1,23 1308:20 issued [2] 1095:21 1096:2 issues [1] 1097:6 1222:22 1236: 25 1253:4 1281:23,24 1299:15 1302:4 1306:6 item [1] 1298:18 items [2] 1254:3 1279:12 itself [15] 1104:1 1191:18 1199:7 1200:10,13 1201:2,6 1206:21 1301:14 1316:14 1317:17 1319:7, 19 1320:14 1321:11 iv [18] 1103:14 1104:9,16 1105:8, 14 1107:1,7,25 1108:10 1221:20 1222:22 1223:24 1226:11,24 1238:10 1258:15 1283:17 1284: 22</p>	<p>1224:9,13 1225:3,10,18,24 1228: 20,25 1229:12 1230:4,8,14,24 1231:2,7 1243:18 1244:7,10,20,21 1245:1,6,17,20 1248:14 1249:21 1262:6,17,21 1273:4 1275:1,10,14, 15,24 1276:5,9,15 1277:7,11,11, 16 1278:6 1285:15 1290:8 1291: 14,25 1293:1,4 1294:6,14 1295:6 1297:11 1302:13,17 1303:5 1304: 5,13 1307:25 1308:8,15,25 1309:6 1311:19 1312:4,17,23 1313:6,21 1316:4,9,12,15 1317:1,23 1318:3, 9,22 1319:3,23 1320:1,5,8,16 1324:4,9,15,20,24 1325:5 1326:5, 9,16 1328:5 1329:16 1330:12,16 1331:11,21 1332:1,4,17 1333:3,9, 16,19 judges [28] 1088:1 1103:2,14 1104:9,16 1106:12 1195:16 1196: 15 1213:20 1214:24 1221:19 1222:7,12 1223:3 1227:13 1232: 11 1235:17 1236:4,7,14 1238:12 1302:18 1306:8,10,18 1308:4 1309:3 1310:24 judges' [2] 1239:1 1325:8 judgment [1] 1254:7 june [1] 1094:22 jurisprudential [1] 1244:15</p>
K			
<p>karen [2] 1088:25 1367:9 karl [3] 1298:5,8,12 keep [4] 1092:22 1191:20 1227:2 1253:24 kellogg [11] 1278:16 1280:2 1282: 1 1287:7,25 1288:6,9,22 1293:9, 14 1294:22 kendall [1] 1089:12 key [4] 1097:13 1190:7 1191:22 1218:7 kidding [1] 1324:13 kind [11] 1207:25 1279:25 1280:11, 19 1282:14,16 1293:22 1310:19 1312:21 1313:14 1314:1 kinds [2] 1214:19 1325:15 knowing [2] 1196:19 1308:10 knowledge [6] 1248:5 1256:16 1302:24 1327:22 1328:1 1330:5 knowledgeable [2] 1107:11 1222: 9 knows [1] 1327:23 kuwait [1] 1283:7</p>			
L			
<p>label [3] 1109:5 1194:9 1254:18 labeled [3] 1237:16,18 1315:14 labels [10] 1107:6,11,14 1215:20 1226:7 1238:25 1241:5 1247:23 1250:14 1257:18 lack [3] 1103:17 1217:25 1280:20</p>			

REVISED AND CORRECTED TRANSCRIPT

OPEN SESSIONS

language [5] 1101:10 1236:2,10, 11,18 large [5] 1215:1 1260:9 1300:14 1316:21 1318:7 1324:22 largely [1] 1260:9 larson [1] 1090:5 last [11] 1095:17 1106:8 1197:23 1212:11 1217:7 1227:17 1242:24 1262:18 1279:1 1317:1 1328:18 late [1] 1237:12 later [3] 1228:7 1292:4 1318:14 laude [1] 1286:6 laughter [2] 1324:14 1332:6 law [2] 1101:15 1274:15 lay [5] 1327:18 1328:2,21 1329:19, 24 1330:23 layers [1] 1102:3 lean-back [3] 1192:7 1194:13 1200:24 learn [1] 1293:3 learned [2] 1227:7 1247:5 least [12] 1098:20 1102:23 1193:23 1204:8 1212:23,24 1277:4 1301:7 1306:6 1310:23 1314:5 1331:23 leave [1] 1229:3 leaves [1] 1281:23 lectured [1] 1283:8 lecturer [1] 1093:25 lectures [1] 1283:6 led [2] 1279:24 1282:4 left [1] 1333:21 left-hand [2] 1205:1 1288:16 legal [2] 1096:12 1313:17 legend [1] 1211:9 legitimate [2] 1221:15 1252:22 lengthy [1] 1238:3 lenski [1] 1207:22 less [7] 1194:9,16 1212:13 1214:17 1310:9 1319:16 1320:21 lessen [1] 1096:10 lesser [1] 1196:21 level [7] 1193:10 1194:1 1206:15 1209:5 1262:15 1292:1 1317:18 levels [4] 1104:23 1215:9,13 1261:11 leverage [1] 1320:15 library [2] 1088:2,18 license [7] 1103:9 1104:19 1216:15 1226:7 1235:24 1240:5 1258:11 licensed [2] 1215:20 1236:5 licenses [5] 1216:14 1260:12,13, 14 1261:14 1305:11 licensing [3] 1103:15 1104:4 1107:21 life [1] 1298:13 lifetime [1] 1301:9 likely [3] 1198:23 1300:20 1306:13 likes [1] 1257:10	likewise [1] 1218:14 limine [2] 1276:22 1304:2 limited [7] 1099:5,7 1191:11 1211:1 1213:8 1221:13 1240:1 limits [1] 1239:20 line [1] 1296:20 link [2] 1288:15,16 list [10] 1100:6 1192:16 1205:20 1243:5 1284:22 1293:20 1294:2 1325:10 1326:5 1329:2 listed [21] 1094:6,9 1202:22 1203:1,8,9,10,11 1204:2,5 1207:13 1243:3,7 1244:6 1289:16 1291:10 1292:4 1293:13 1294:5 1300:6 1325:19 listen [2] 1250:12 1259:24 listened [2] 1208:13 1259:17 listening [9] 1200:18 1202:14 1208:9,14 1210:3,17,18,24 1211:13 listens [2] 1259:8 1260:3 lists [2] 1284:18 1326:21 litigants [1] 1107:6 litigated [1] 1106:25 litigating [1] 1106:25 litigation [3] 1098:10 1100:8 1295:17 little [7] 1214:21 1226:19 1281:19 1302:1 1317:11,12 1318:14 live [1] 1095:15 lived [1] 1287:21 llp [5] 1089:16,23 1090:8,14 1091:6,12 logic [1] 1331:4 long [4] 1193:1 1225:21 1278:24 1322:9 longer [2] 1257:21 1320:24 look [22] 1109:3 1197:6,13 1205:13 1210:22 1212:4,11 1228:22 1229:15 1232:10,11 1254:20 1255:23 1284:11 1292:13 1303:10 1305:5 1313:2 1320:4 1325:23 1326:3 1327:12 looked [9] 1227:1 1245:15 1246:23 1248:15 1296:22 1321:1 1323:18,19,20 looking [10] 1105:10,16,17 1194:18 1197:2 1211:3 1222:7 1230:16, 17 1290:15 looks [5] 1105:6 1234:1 1324:22, 24 1326:7 loop [2] 1318:17 1320:19 los [1] 1089:25 lose [2] 1313:1 1324:23 loses [1] 1320:23 losing [3] 1257:21 1316:20 1317:22 lot [5] 1194:14 1212:17 1258:22 1281:23,23 1283:2 lots [1] 1318:8	low [2] 1319:13,14 lower [9] 1240:23 1311:22 1312:1, 7,9 1313:11,13 1319:9,15 lowest [2] 1204:3 1205:20 loyalty [1] 1291:8 lunch [1] 1224:15 lys [24] 1195:12 1197:24 1225:8 1276:3,12 1278:13,15 1285:2,6,14, 19 1296:2,6 1302:19,25 1303:25 1307:25 1316:4 1327:16 1328:16 1329:4 1330:4 1332:8 1365:5 lys's [2] 1276:23 1302:9 lys's [2] 1216:12 1276:20 <p style="text-align: center;">M</p> machines [2] 1319:16,17 macro/microeconomics [1] 1282:7 made [13] 1093:6 1094:19 1198:22 1215:10 1218:2,2 1231:3 1234:23 1247:13 1248:10 1275:12,13 1298:15 madison [1] 1088:19 magnitude [1] 1257:20 main [1] 1292:23 maintain [3] 1231:9 1327:25 1328:20 major [8] 1101:11 1103:10 1107:6, 14 1226:7 1237:1 1238:24 1241:5 majority [1] 1250:20 management [1] 1289:3 manges [2] 1090:8,14 manner [1] 1332:11 manuscripts [2] 1300:11,13 many [10] 1102:4 1228:7 1249:23 1281:4 1286:22 1301:5,9 1314:11, 11 1325:3 margaret [1] 1091:5 margin [25] 1316:10,13,18,19,22 1317:3,4,11,16,20,24 1318:8,14, 19 1319:6,7,10,20,23 1320:13,20 1321:2 1322:5,8 1323:1 margins [2] 1195:12 1323:2 marked [5] 1201:22 1209:20 1278:9 1304:11 1331:19 marked/received [2] 1365:15 1366:1 market [90] 1096:11 1097:2,14 1098:1,3,11,12,17 1099:12 1101:14 1102:8,9 1103:15 1104:4,4,19 1105:5,6,10,15,17,19,25 1106:23 1107:17 1108:6,9,9,22,23 1194:21 1195:20,22 1196:5,12,12,20 1197:3,3,6,11,13,15,17,18 1200:15,15 1213:19,24 1214:5,10,12,13,16,18, 25 1215:12 1216:8 1217:2,19 1218:8,9,13 1219:15 1222:24,24 1223:1 1226:7,24 1235:19 1237:5, 10,11 1238:4,6 1254:20 1257:19, 1260:16 1261:17 1262:14 1299:9	1306:11,13 1308:3 1309:2 1310:12,24 1322:19,20,20 market-based [1] 1195:2 marketing [2] 1296:15 1297:4 marketplace [5] 1104:20 1223:17, 24 1242:5 1252:18 markets [5] 1106:15 1214:6 1218:4 1223:3,15 1246:10 1261:10 1280:13 master [1] 1286:5 master's [1] 1093:3 matched [1] 1245:13 materials [2] 1294:19 1302:19 math [4] 1232:13 1234:7,12 1259:10 mathematically [2] 1241:8 1259:12 matter [8] 1088:4 1095:18 1100:20 1101:15 1196:13 1226:13 1295:11 1331:12 matters [7] 1097:2 1101:2,3 1214:11 1230:18 1249:1 1323:20 maximum [1] 1216:13 maybe's [1] 1212:18 mean [14] 1096:12 1106:9 1219:24 1238:1 1247:1 1251:5 1257:15 1276:17 1293:17 1294:4 1305:18 1315:15 1320:4,10 meaning [3] 1215:18 1233:7 1321:12 means [3] 1198:17 1260:23 1315:7 meant [1] 1095:15 measure [4] 1102:7 1262:14 1281:4 1320:1 measures [1] 1323:15 measuring [1] 1216:11 media [2] 1325:16,16 medicare [1] 1097:18 meet [1] 1219:16 meets [1] 1230:22 member [5] 1228:13,16,17 1289:8 1290:2 members [1] 1289:14 memorize [2] 1100:2 1102:12 memory [5] 1102:16 1109:1,1 1236:11 1242:18 mention [1] 1256:2 mentioned [2] 1281:17 1282:19 mentor [1] 1298:12 meredith [1] 1090:7 merge [1] 1274:12 merger [11] 1094:14 1096:10,15, 23 1097:12 1098:6,8 1274:10,13 1275:10 1305:10 mergers [1] 1296:9 merging [1] 1096:22 met [1] 1107:19 method [5] 1097:4,14 1216:25 1226:22 1311:6
---	--	--	---

REVISED AND CORRECTED TRANSCRIPT
OPEN SESSIONS

<p>methodology [7] 1104:14 1222:15 1234:7 1235:16 1244:14 1261:25 1282:5</p> <p>metric [7] 1262:3,5 1306:16 1315:24 1316:14 1317:17 1319:24</p> <p>metrics [5] 1315:3,9,11 1316:5 1318:23</p> <p>micro [1] 1287:2</p> <p>mid-stream [1] 1279:11</p> <p>mid-tier [2] 1104:22 1229:20</p> <p>middle [2] 1228:25 1283:6</p> <p>might [5] 1092:5 1234:16 1254:6 1282:12 1312:8</p> <p>mile [1] 1322:9</p> <p>million [2] 1316:24,25</p> <p>mind [4] 1256:12 1273:13,14 1282:13</p> <p>mine [1] 1261:23</p> <p>minor [1] 1099:16</p> <p>minus [2] 1315:7 1317:6</p> <p>minute [1] 1323:8</p> <p>minutes [1] 1333:5</p> <p>misinterpreted [1] 1206:1</p> <p>misinterpreting [1] 1288:4</p> <p>misleading [1] 1302:3</p> <p>misquote [1] 1099:25</p> <p>misreporting [1] 1302:3</p> <p>misrepresenting [1] 1297:5</p> <p>missed [1] 1094:11</p> <p>missing [2] 1256:1 1284:19</p> <p>mistake [1] 1305:20</p> <p>mistaken [1] 1198:6</p> <p>misunderstanding [1] 1297:5</p> <p>mix [1] 1319:18</p> <p>mobile [1] 1200:8</p> <p>mobility [1] 1193:9</p> <p>mode [1] 1193:24</p> <p>modeled [1] 1221:20</p> <p>modeling [3] 1236:21,23 1300:15</p> <p>models [2] 1289:24 1305:14</p> <p>modest [1] 1215:7</p> <p>modestly [1] 1320:20</p> <p>modified [1] 1261:3</p> <p>moment [5] 1096:1 1213:2 1215:25 1224:7 1234:6 1276:4 1294:7,10</p> <p>monetary [3] 1298:7,8,19</p> <p>money [5] 1316:20,23 1317:22 1319:2 1324:23</p> <p>monitoring [2] 1281:13 1298:22</p> <p>monopolist [7] 1097:5,8,15,17,21,22 1098:2</p> <p>monopolistic [1] 1322:20</p> <p>monopoly [1] 1215:11</p> <p>month [13] 1248:3 1257:20 1259:9,11,15,24 1306:17,19 1307:17 1308:16 1309:1 1311:16 1316:25</p> <p>months [2] 1228:7 1250:5</p> <p>morning [4] 1092:3 1093:1,2 1273:9</p>	<p>morning's [1] 1277:25</p> <p>most [11] 1095:9 1198:23 1200:7 1229:2 1230:1,6 1231:5 1305:9 1306:13 1315:3,10</p> <p>motion [5] 1101:6 1225:12 1276:22 1302:10 1304:1,6</p> <p>motions [1] 1100:25</p> <p>motivated [1] 1251:24</p> <p>move [13] 1198:9 1245:19 1252:6,14 1276:4 1278:3 1303:23 1313:18 1326:12 1327:9,21,21 1330:20</p> <p>moved [4] 1099:2 1279:23 1282:1 1331:5</p> <p>movie [1] 1230:10</p> <p>moving [4] 1196:11 1224:7 1252:23 1313:16</p> <p>mp3 [1] 1205:5</p> <p>much [13] 1203:1 1231:14 1236:16 1238:13 1253:20 1260:2 1276:1 1287:1 1312:12,16 1313:18 1317:8 1319:10</p> <p>multi-year [1] 1254:10</p> <p>multiple [3] 1217:15 1221:23 1292:16</p> <p>multiplied [1] 1311:15</p> <p>multiply [1] 1241:3</p> <p>multiplying [2] 1232:19 1241:10</p> <p>multitude [1] 1281:10</p> <p>music [24] 1089:6,6,7,20 1091:2 1190:14,20,22,23 1191:1,5,7,9,13 1192:25 1194:3 1198:24 1205:19 1210:2 1212:7 1232:4 1233:15,25 1322:17</p> <p>musicians [1] 1089:3</p> <p>musicwatch [1] 1208:25</p> <p>must [2] 1103:3 1332:2</p> <p>myself [4] 1217:16 1277:19 1287:2 1306:5</p>	<p>needs [1] 1219:16</p> <p>negotiated [2] 1260:14 1261:15</p> <p>negotiating [2] 1279:8,13</p> <p>negotiation [7] 1254:17 1260:18,23 1280:18 1282:20 1285:4 1302:12</p> <p>negotiations [5] 1279:25 1280:9 1290:12 1303:4,5</p> <p>neither [4] 1098:23 1108:23 1218:13 1283:3</p> <p>network [1] 1324:9</p> <p>neutral [3] 1252:16,19 1253:4</p> <p>never [10] 1107:18 1196:3,7 1244:6 1275:13,13 1288:1 1289:9 1293:18,25</p> <p>nevertheless [2] 1104:2 1199:15</p> <p>nevo [1] 1098:25</p> <p>new [15] 1089:17 1090:10,10,16 1091:8,8 1101:6 1193:3 1195:23 1196:2 1203:15 1240:22 1256:21 1257:1 1274:1</p> <p>newer [1] 1106:3</p> <p>newly [1] 1279:7</p> <p>newness [1] 1221:10</p> <p>next [17] 1094:10 1190:4 1198:17 1204:2,3,21 1205:10,12,23 1206:25 1233:6 1276:3 1277:9 1279:1 1293:4 1298:25 1314:20</p> <p>nice [1] 1296:3</p> <p>nicely [1] 1227:5</p> <p>non-degree [1] 1294:23</p> <p>non-distorting [1] 1253:25</p> <p>non-interactive [5] 1206:13 1221:21 1236:6 1239:6,11 1241:12 1242:1 1258:11</p> <p>non-music [4] 1192:25 1232:18 1233:15,25</p> <p>none [3] 1236:19,19 1331:2</p> <p>north [1] 1283:12</p> <p>northwestern [3] 1278:17 1280:3 1296:17</p> <p>note [5] 1100:21 1201:25 1211:24 1220:19 1223:17 1238:8 1276:24 1286:1</p> <p>noted [3] 1232:6 1238:8 1275:15</p> <p>notes [2] 1210:25 1367:5</p> <p>nothing [9] 1106:10 1210:11 1216:25 1222:2 1225:16 1238:11 1252:24 1316:19 1317:17</p> <p>noticed [1] 1225:11</p> <p>notwithstanding [2] 1194:20 1318:19</p> <p>november [1] 1095:1</p> <p>number [26] 1094:6 1100:11 1107:13 1197:8 1208:6,12 1209:19 1232:24 1240:1 1250:18 1259:9 1281:3 1282:12,12 1289:8,14 1299:1,9 1300:14 1304:11 1306:12 1311:15 1316:18 1318:2 1324:22 1326:6</p>	<p>numbered [2] 1209:23 1298:17</p> <p>numbers [11] 1194:25 1210:7 1234:6,17 1259:13 1273:8 1278:8 1314:21 1315:14 1329:7 1331:18</p>
O			
			<p>object [5] 1243:1 1285:5 1304:4 1326:2,10 1327:11</p> <p>objection [13] 1209:14,17 1278:6 1285:7,13 1304:3 1326:11 1327:16 1328:15,25 1329:1 1330:1 1332:10</p> <p>observe [1] 1229:17</p> <p>observed [2] 1106:15 1200:15</p> <p>obsolete [2] 1105:24 1106:2</p> <p>obtained [2] 1247:15 1248:12</p> <p>obviously [19] 1193:3 1199:4 1203:19 1212:9 1219:25 1222:22 1234:10 1237:5 1238:2,17 1241:19 1251:3,6 1261:6 1262:12 1302:18 1306:2 1315:8 1330:21</p> <p>occasions [1] 1301:5</p> <p>occur [1] 1216:7</p> <p>occurred [1] 1240:22</p> <p>occurs [1] 1260:23</p> <p>odds [1] 1102:5</p> <p>offer [10] 1102:19 1192:7 1193:25 1209:15 1239:15 1295:16 1304:8 1318:13 1329:20 1330:13</p> <p>offered [4] 1209:16 1240:3 1258:24 1294:20</p> <p>offering [5] 1191:8 1203:12 1258:6 1331:21 1332:13</p> <p>offerings [1] 1203:15</p> <p>offers [5] 1235:21 1258:7,23 1259:1 1305:14 1311:25</p> <p>office [5] 1274:7,10,11,14,18 1291:4</p> <p>offset [1] 1215:9</p> <p>offsetting [2] 1101:13,17</p> <p>okay [5] 1092:20 1094:2,10,19 1095:3,8 1096:7 1098:9 1100:5,24 1102:17 1103:7 1106:20 1190:10 1191:20 1198:22 1200:5 1201:2 1202:5,20,25 1203:7 1205:18 1206:25 1207:7,11,24 1208:2,12 1213:15 1227:22 1230:8 1245:19 1253:16 1258:16 1259:3,11,15 1276:5 1277:16 1284:6,10 1285:24 1298:17 1299:9,15 1302:8 1303:22 1304:13 1315:1 1321:6,18 1323:3 1324:20 1325:19,22 1326:19 1327:4</p> <p>oligopoly [1] 1103:17</p> <p>omission [1] 1262:7</p> <p>on-line [1] 1208:9</p> <p>once [2] 1197:16 1207:12</p> <p>one [97] 1093:17,22 1094:17 1097:6,10 1100:7 1101:22 1108:15 1191:18 1193:21 1195:20,21,25</p>

REVISED AND CORRECTED TRANSCRIPT

OPEN SESSIONS

<p>1196:1 1207:21 1208:3,9 1209:6 1213:7 1215:3,15,23 1216:9 1217: 21 1219:15,16,21 1221:5,17 1224: 14 1227:1,19 1228:13 1237:4 1238:3 1239:12,20,21,22,24 1240: 17,20 1245:9,12 1248:3 1252:2,3, 14 1253:15 1255:8,19 1257:20 1261:24,25 1274:10,11,25 1277: 24 1279:1,12 1280:24,25 1283:3 1289:2 1290:1,2 1291:7 1292:15, 17 1294:3 1298:4 1300:20 1304:3 1305:3,8,10 1308:2 1314:12 1315: 23 1317:1 1318:21 1319:2,8,9,19, 21,22 1320:2,5 1321:18 1325:16 1326:4,21 1327:12,13,18 ones [5] 1214:4 1216:9 1229:12 1243:6 1331:22 only [20] 1095:17,25 1106:12 1193: 12 1196:14,16 1203:7 1208:8 1211:21 1214:25 1218:1 1226:9 1241:15 1249:12 1251:8 1287:20 1312:17 1317:25 1319:21 1333:1 operating [1] 1315:6 operations [1] 1315:7 opined [2] 1226:15 1310:7 opining [1] 1308:14 opinion [4] 1096:2 1194:21 1219: 22 1309:25 opinions [5] 1100:25 1101:8 1102: 19,21 1106:21 1330:8 opportunities [1] 1291:1 opportunity [1] 1330:22 opposed [1] 1316:3 opt-in [3] 1248:17,20 1249:6 opt-out [3] 1248:17,22 1249:6 optimal [4] 1103:7 1257:5 1281:25 1282:8 optimize [3] 1219:13 1257:1 1258: 4 opting [1] 1249:16 option [13] 1193:25 1194:5,6 1203: 22 1204:25 1205:2,5,7,8 1211:19 1229:21 1260:20,21 options [5] 1206:7 1217:19 1222: 18 1229:21 1252:17 order [4] 1225:19 1257:20 1318:7 1323:3 ordover [20] 1226:22 1227:25 1228:3 1231:12 1233:7,12 1234:5, 15 1235:10,21 1236:25 1237:7,14 1238:7 1242:9,12 1244:2,19,24 1245:11 ordover's [10] 1227:10 1231:18 1235:15,18 1236:8,15 1242:24 1243:2,11 1245:14 orszag [5] 1092:12 1093:1 1273:7 1275:25 1365:3 orszag's [1] 1243:25 ostroff [1] 1089:22 other [41] 1093:12 1094:3 1095:11</p>	<p>1099:2,19 1101:20 1107:4 1108: 21 1191:1,17,22 1199:5 1203:9 1204:25 1227:16 1229:5,7,8,21 1234:13,22 1237:3,4 1245:12 1252:4 1253:15 1255:9,20 1261: 24 1277:21,23 1281:4 1292:17 1295:22 1299:22 1300:25 1312: 13,20 1319:21 1321:19 1322:4 others [7] 1105:9 1229:22 1234:23 1273:16 1286:23 1295:18 1327: 15 otherwise [5] 1196:20 1215:21 1216:15 1257:22 1279:16 1284: 24 1330:17 1333:19 ought [1] 1215:8 ourselves [1] 1316:16 out [24] 1095:4 1098:5,7 1102:25 1192:7 1200:7,17 1234:24,25 1235:2 1241:14 1242:3 1243:5 1244:13 1249:16 1281:22 1282: 13 1286:5,13 1311:24 1324:19 1330:16 1331:1 1333:6 outcome [3] 1254:15,18 1275:5 outline [1] 1227:5 outset [2] 1274:2 1308:2 outside [5] 1101:14 1236:17 1238: 14 1262:23 1291:6 over [16] 1097:17 1202:17 1204:25 1217:7 1233:5 1279:20 1287:7 1294:10 1305:9 1318:20 1320:20, 22 1321:4 1322:1 1323:13,13 overall [2] 1099:17 1232:4 overlap [2] 1219:25 1290:23 overruled [1] 1273:19 oversimplified [1] 1232:2 overview [2] 1288:11 1305:2 own [5] 1192:18 1199:6 1212:25 1281:7 1295:19 1315:9 1329:6 1332:15</p>	<p>21 papers [1] 1284:17 paragraph [19] 1190:11 1191:20 1192:2 1200:6,17 1201:9 1210:16 1212:5,10,12,22 1228:22 1229:1 1243:23 1246:1 1251:17 1255:22 1256:1,4 paragraphs [2] 1199:23 1215:10 paraphrase [1] 1230:10 pardon [5] 1208:8 1212:8 1244:9 1251:5 1287:15 part [29] 1098:20 1105:7 1106:10 1193:13,18 1194:7,17 1196:22 1200:3 1208:22 1209:14 1214:1 1218:21 1238:4,5 1247:23 1255: 15 1280:20 1282:3,15 1285:11 1291:19 1296:12 1302:7 1305:11, 13 1311:8 1313:20 participants [2] 1254:17 1277:21 particular [2] 1109:5 1273:12 particularly [2] 1292:23 1308:2 parties [5] 1107:4 1202:2 1274:13 1275:18,20 1295:17 partner [2] 1282:1 1283:5 parts [1] 1101:18 party [1] 1106:25 pass [5] 1322:14,17,19,21,24 passed [1] 1291:23 passing [1] 1286:25 past [5] 1196:1 1226:18 1287:8 1305:9 1323:9,14 path [2] 1281:25 1313:1 patterns [1] 1257:23 paul [1] 1091:3 pause [1] 1192:23 pay [11] 1193:5 1195:17 1196:22 1223:10 1248:21 1249:2 1250:11 1253:16 1254:9 1259:21 1261:20 paying [17] 1195:8 1216:16 1241: 20 1248:22 1249:5,8 1250:21,22, 25 1251:4,19,25 1253:9,15 1256: 22 1258:15 1282:9 payment [5] 1238:23 1252:4,16 1255:11 1257:11 1262:3 payments [5] 1215:21 1233:8 1245:23 1250:14,15 pays [4] 1251:9 1258:10 1259:3 1260:2 peak [1] 1092:6 peer-review [1] 1293:22 peer-reviewed [2] 1280:23 1281: 8 pending [1] 1276:22 penguin [1] 1100:9 people [12] 1198:23 1208:13 1211: 16 1222:8 1249:11 1250:18 1281: 25 1282:8,15 1283:3 1291:22 1333:5 per [15] 1108:16 1197:5 1240:1,1 1259:11,15 1262:10 1306:16,17,</p>	<p>19 1307:17 1308:4,16 1309:1 1311:16 per-play [7] 1104:18 1220:17 1221: 22 1222:13,14 1223:18,25 per-subscriber [17] 1238:23 1241:3 1249:3 1259:11 1261:22 1306:17,19 1307:6,16 1308:16 1309:1,10,20 1310:16 1311:2 1313:25 1320:25 percent [54] 1097:23 1106:17 1197:4,5 1204:4,6 1205:9,22 1210:2 1216:6,11 1217:22 1232:3, 20 1233:10,11 1234:11,11 1235:2, 3,11,13,13 1240:8 1241:9,17,22 1249:11,13 1295:5 1306:23 1307: 3 1310:9,11 1311:7,9,12,23 1312: 21 1313:24 1314:13,14 1316:20, 23 1317:12,13,20 1319:20 1321: 20,23 1322:2,3,6,25 percent-of-revenue [1] 1232:17 percentage [5] 1197:4 1202:21 1233:8 1240:23 1311:22 percentage-of-revenue [5] 1231: 23 1233:16 1235:6 1242:5 1261: 21 1262:11 1306:20 1311:4 percentages [1] 1234:25 perfectly [1] 1322:18 perform [2] 1190:20,22 performance [11] 1190:23 1212:6, 7,12 1259:4 1305:9 1316:5 1321: 20 1323:6,9,17 performances [3] 1259:8,18,24 performed [1] 1322:11 performing [1] 1102:10 perhaps [3] 1216:12 1224:12 1290:22 period [13] 1193:2 1196:6 1235:24 1248:3,19 1251:1,8 1254:10 1257: 4 1292:17 1306:14 1307:15 1309: 21 periods [2] 1105:24 1292:16 person [1] 1293:18 personal [3] 1327:22,25 1330:5 personnel [1] 1332:24 perspective [14] 1193:17 1194:4 1196:9 1217:14 1218:17 1219:8 1221:1 1253:5,21 1254:15,16,24 1313:17 1314:11 persuasive [1] 1099:7 pertinent [1] 1107:12 peter [1] 1089:22 ph.d [13] 1093:7,9 1278:22 1279:9 1280:12 1286:1,9,14,17,19,23 1291:24 1292:1 phone [2] 1203:20 1208:14 phones [1] 1200:8 phrase [1] 1214:21 pick [3] 1099:18,19 1259:9 picked [1] 1260:7 picture [2] 1255:2 1296:3</p>
--	--	---	--

REVISED AND CORRECTED TRANSCRIPT
OPEN SESSIONS

<p>piece [1] 1253:17 pipeline [1] 1279:10 pitch [1] 1295:2 place [7] 1105:8,19 1106:3 1197:10 1200:7 1253:2,6 places [2] 1222:6 1296:22 plan [1] 1230:11 platform [1] 1202:14 play [1] 1273:8 player [2] 1205:2 1237:9 players [1] 1200:16 playlists [1] 1200:19 plays [3] 1103:19 1109:4 1212:14 please [25] 1092:3 1097:8 1105:1,3 1200:1,22 1207:2 1208:5 1209:24 1220:12 1225:3 1233:1 1262:23 1276:9,10,15 1278:13 1288:21 1293:19 1294:2 1302:17 1303:10 1304:17 1307:9 1333:9 pleasure [1] 1276:19 plugged [2] 1234:7,17 plus [2] 1245:15 1289:4 point [33] 1095:3 1098:24 1099:2,16 1104:7 1106:8 1190:18 1191:3,11 1192:7 1197:7 1200:7,17 1203:16,19 1208:3 1224:10 1227:1 1228:1 1234:24 1238:25 1242:15 1243:22 1254:12 1286:5,13 1287:15 1292:15 1308:22 1320:3 1321:3 1331:1 1333:5 pointed [2] 1099:19 1228:21 points [4] 1199:23 1222:1 1223:4 1305:4 policy [1] 1298:8 political [1] 1298:4 popular [3] 1283:1,10 1315:3 population [2] 1211:21,21 portion [2] 1276:22 1277:5 portions [1] 1284:16 posed [1] 1244:23 position [5] 1320:2 1327:17 1328:16 1330:4,4 positions [1] 1300:6 positive [1] 1223:10 possible [3] 1094:11 1255:24 1320:19 potential [2] 1216:6 1229:9 potentially [4] 1249:18 1252:21 1257:12 1330:8 power [3] 1305:6 1309:12 1322:21 preceding [2] 1203:16,18 precise [15] 1096:12 1099:8 1101:10 1102:1,15 1103:25 1212:10 1216:3 1226:21 1229:25 1236:10 1237:14 1260:6 1261:7 1308:23 precisely [2] 1109:3 1220:5 1226:13 1235:10 1242:11 1245:5,11 1256:12 predicate [1] 1198:10 predicated [1] 1238:19</p>	<p>preexisting [1] 1088:10 prefer [2] 1277:3 1285:9 preliminary [2] 1326:22 1327:14 1328:6,8 1331:13,23 prendergast [1] 1333:2 prep [1] 1093:18 prepared [4] 1100:21 1208:25 1235:16 1276:2 preparing [4] 1228:5,10 1236:1 1306:4 presence [4] 1108:13 1216:22 1219:14 1308:17 present [2] 1099:21 1198:4 1219:23 1252:2 1312:14 1332:12 presentation [2] 1195:4 1208:2 presented [2] 1096:22 1099:11 1105:13 1238:7 1246:25 1252:9 1259:14 1275:14 1309:3 presenting [1] 1237:7 presents [1] 1199:13 pretty [1] 1273:20 prevail [1] 1216:22 prevailing [4] 1214:10 1226:6 1306:14 1309:17 previn [2] 1089:15 1277:20 previous [2] 1246:25 1302:21 previously [3] 1092:13 1297:18 1300:23 price [25] 1103:17 1107:20 1108:1,7 1193:6 1216:13,17,22,23 1239:5,7 1240:8,12 1241:11,16,19,23 1242:1 1309:18 1317:5,7,23,25 1318:1 1320:25 price-fixing [1] 1100:16 prices [7] 1097:23 1098:12 1198:8 1215:12 1241:2 1242:7 1298:19 pricing [1] 1215:12 prima [1] 1096:9 primary [3] 1234:18 1235:18 1236:15 princeton [1] 1090:16 principal [1] 1101:7 principle [2] 1098:5 1104:13 prior [13] 1095:8 1105:23 1226:9 1228:1 1232:21 1235:25 1243:24 1244:14,15,16 1275:8 1277:25 1283:14 privately [1] 1097:20 privy [3] 1262:22 1332:25 1333:20 pro-competitive [3] 1096:17 1273:12,21 probability [1] 1289:24 probable [1] 1096:23 probably [2] 1109:9 1285:12 1301:8,10 1315:10 1318:9 probative [1] 1332:15 proceeded [3] 1109:12 1262:24 1333:22 proceeding [18] 1102:19 1107:7,8 1193:12 1195:18 1196:19 1213:</p>	<p>17 1226:11,12 1235:21 1258:15 1301:19 1305:22 1306:25 1308:20 1310:6 1331:2 1367:6 proceedings [2] 1094:4 1226:18 1277:25 1283:14 1300:24 1301:1,1 1305:12 1306:4 process [5] 1234:8 1243:4 1246:19,21 1247:21 produced [3] 1326:20,23 1329:6 product [5] 1097:17,18 1194:19 1241:20 1318:6 products [1] 1239:15 profess [1] 1255:1 professor [95] 1098:25 1195:12 1197:23 1199:3,12 1216:12 1225:8 1226:22,23 1227:10,25 1228:3 1231:12 1233:7 1234:4,15 1235:10,15,18 1236:14,25 1237:7,13 1238:7 1242:9,12 1243:2,11 1244:1,19,24 1245:11,14 1246:14,15 1259:14 1276:3,20,23 1278:13,16,18,24 1279:2,3,5,5,19 1280:2,6 1281:17 1282:19 1283:13,23 1284:8 1285:2,6,14,19 1287:11,18 1296:2,6 1297:15 1300:22 1301:23 1302:9 1303:9,25 1304:17 1305:14,16,21 1306:15 1309:9,19 1310:3,15 1311:1 1313:23 1314:19 1315:13 1318:13 1320:18 1323:3,22 1324:5 1325:7,22 1326:13 1327:16 1328:16 1329:4 1330:4 1332:8 professors [1] 1291:2 professorship [2] 1278:25 1287:25 proffered [1] 1290:10 profit [2] 1317:15 1318:7 profit-maximizing [2] 1256:24 1257:7 profitability [2] 1318:18 1321:4 profitable [3] 1097:24,25 1320:22 profits [1] 1317:9 program [3] 1256:25 1280:8 1294:22 programs [2] 1255:4 1294:23 prominence [1] 1204:22 promise [2] 1298:15,16 promote [1] 1291:5 promotion [1] 1246:13 proper [2] 1097:4 1302:5 properly [1] 1097:25 property [1] 1230:17 proposal [5] 1098:18 1250:20 1255:16,17,19 propose [7] 1104:23 1209:3 1215:18 1217:11 1231:11 1255:11 1256:20 proposed [2] 1094:13 1096:9,21 1098:17 1103:7 1230:3 1231:11 1249:2</p>	<p>proposing [2] 1195:24 1214:9 1226:5 1229:6 1248:25 1261:23 1262:2,8 proposition [2] 1103:5 1192:6 1194:24 1198:11 1220:24 1261:13 provide [7] 1095:25 1097:12 1202:9 1206:15 1221:8 1251:8 1292:24 provided [5] 1094:3 1097:20,20 1226:16 1246:6 provides [3] 1194:3 1204:19 1252:5 providing [1] 1193:16 provision [4] 1108:14,15,24 1273:18 provisions [5] 1108:19 1248:17 1262:13 1273:10,22 psychologist [1] 1294:19 psychology [2] 1283:2 1295:3 psychology-driven [1] 1282:3 public [3] 1207:14 1209:4 1321:17 publications [2] 1281:10 1284:16 1297:22 1298:11 1299:22 1300:2 publications/books [1] 1297:25 publicly [2] 1207:15 1247:12 publish [1] 1298:14 published [12] 1280:18 1281:5,7 1290:7,7 1298:20,21 1299:4,11,16,17,23 publishers [1] 1100:17 pull [1] 1295:24 purchased [2] 1205:3 1307:23 purchasing [2] 1305:6 1309:12 pure [2] 1218:17 1260:19 1262:11,12 1299:19,19 purely [1] 1260:25 purported [1] 1102:7 purpose [4] 1291:1 1292:23 1331:23,24 purposes [5] 1106:11 1213:10 1239:12 1240:10 1246:12 pursuant [1] 1258:10 pursue [1] 1093:7 pursuing [1] 1236:20 put [20] 1101:1,8,17 1191:22 1197:10 1209:3 1212:3 1217:21 1220:1 1257:10 1262:4 1276:21 1288:5 1291:12,13 1293:19 1294:6 1306:16 1315:16 1329:18 putative [1] 1097:17 puts [1] 1312:19 puzzled [1] 1196:17</p>
---	--	--	---

Q

qualification [1] 1297:2
qualifications [5] 1274:3 1297:8 1301:18 1302:10 1303:1
qualified [2] 1283:13 1285:6 1300:23,25 1301:6,13 1302:24 1303:1 1331:16

REVISED AND CORRECTED TRANSCRIPT
OPEN SESSIONS

<p>qualify [5] 1285:2 1291:2,3 1293:7 1302:10</p> <p>qualifying [1] 1285:13</p> <p>quantitative [1] 1199:2</p> <p>quantity [2] 1260:4 1318:2</p> <p>question [41] 1094:10 1097:13 1108:18 1196:6 1197:14,16 1198:17 1203:3 1205:11 1213:3,13 1215:5 1227:16 1233:23 1240:19 1243:17,19,20,21 1244:20,22,23 1248:23 1249:1,7,8,17 1256:11 1261:4,8 1274:25 1292:16 1293:5 1308:24 1312:5 1314:15,22 1317:1 1318:22 1330:2</p> <p>questioned [1] 1231:15</p> <p>questions [15] 1092:17 1196:14,16 1227:7 1229:24 1243:14 1245:22 1273:7 1274:3 1275:23 1295:8 1297:7,10,19 1302:9</p> <p>quick [1] 1324:2</p> <p>quickly [1] 1290:13</p> <p>quite [3] 1222:5 1258:19 1322:7</p> <p>quote [4] 1098:22 1099:8 1220:22 1230:13</p> <p>quotes [4] 1099:18,19,25 1101:25</p> <p style="text-align: center;">R</p> <p>radio [27] 1088:10 1089:5 1090:2 1190:6,14 1202:13 1204:23,25 1205:6 1206:6,23 1208:9,13,18,22 1210:19 1213:19 1233:13 1239:13 1251:12 1258:7 1315:25 1321:7,12 1324:6,16 1325:16</p> <p>radio/ [1] 1205:18</p> <p>raise [1] 1276:10</p> <p>raised [2] 1097:22 1225:6</p> <p>ran [1] 1099:5</p> <p>randi [1] 1090:4</p> <p>random [1] 1259:9</p> <p>range [8] 1106:18 1217:20,22 1233:10 1235:13 1260:6,7,8</p> <p>ranged [1] 1233:9</p> <p>ranging [1] 1289:23</p> <p>ranked [1] 1281:3</p> <p>ransom [1] 1089:21</p> <p>rao [1] 1089:13</p> <p>rapidly [1] 1210:2</p> <p>rate [74] 1103:8 1104:11,16 1194:22 1195:2 1196:1 1204:3 1215:9,22 1217:3 1219:5 1223:20 1231:11,23 1232:17 1233:16 1235:6 1236:16 1238:14 1249:9,10,14,19 1251:10 1255:16 1258:15 1260:23,24 1261:21,22 1262:15 1306:7,11,14,20,22,23,24 1307:6,20 1308:3,8,10 1309:2,2,10,17,20,21,23 1310:2,7,12,16,16,22,24 1311:2,4,10,13,21,22,24 1312:14 1313:25,25 1314:10,14,16 1321:20,24 1322:4,13</p>	<p>ratemaking [3] 1226:6,18 1234:19</p> <p>rates [64] 1088:7 1102:22 1103:2,8 1104:18,23 1195:2,7,8,10,20,22 1196:5,12,12,19 1197:3,3,6,13,15,17,18 1198:8 1213:16,23 1214:5,10 1215:8 1216:7 1217:1 1219:16,23 1220:15,17,20 1221:3,12,16,17,22 1222:1,2,4,8,13,14 1223:4,7,11,18,25 1226:6 1234:25 1235:23 1236:15 1238:13 1247:6,9 1255:25 1256:16,19 1259:22 1262:14</p> <p>rather [8] 1194:16 1219:4 1222:13 1260:22 1290:13 1320:11,13 1329:12</p> <p>ratio [8] 1104:10 1105:20 1198:9,10 1199:18 1239:4 1241:1 1242:7</p> <p>rational [6] 1220:20 1221:3,18 1222:16,18,20</p> <p>rational [2] 1255:3,6</p> <p>re [1] 1100:8</p> <p>reached [2] 1278:1 1306:8</p> <p>react [1] 1292:9</p> <p>read [10] 1196:25 1221:24 1222:3,6 1230:5 1237:23 1242:15 1245:14 1308:11,13</p> <p>readily [1] 1202:3</p> <p>reading [8] 1211:9 1218:22 1222:10,10 1223:6 1235:25 1236:9 1243:24</p> <p>reads [1] 1233:6</p> <p>ready [1] 1092:8</p> <p>real [4] 1102:4 1292:6 1296:7 1317:10</p> <p>reality [2] 1322:18,23</p> <p>realized [1] 1283:3</p> <p>really [13] 1102:22 1196:11 1204:15 1249:17 1250:7 1293:17 1313:3 1322:23 1323:20,20 1331:5,14 1333:1</p> <p>realm [1] 1244:17</p> <p>reason [4] 1229:25 1253:8 1315:19 1331:17</p> <p>reasonable [9] 1106:18 1217:20 1226:17 1229:2 1230:1,6 1231:5 1235:23 1260:8</p> <p>reasonableness [2] 1236:17 1238:15</p> <p>reasonably [3] 1228:17 1243:12 1302:6</p> <p>reasoning [3] 1099:13 1217:23 1218:12</p> <p>reasons [6] 1194:25 1249:3 1252:22,24 1261:2,17</p> <p>rebuttal [13] 1105:23 1212:4 1215:24 1217:5,10 1225:13 1226:17 1247:4 1255:10,21 1276:23 1303:11,25</p> <p>recall [10] 1094:20 1102:13 1212:9 1226:19,25 1227:10 1235:25 1251:21 1273:23 1274:7</p>	<p>receive [1] 1250:10</p> <p>received [10] 1209:20 1216:14 1228:4 1253:14 1257:22 1278:9 1286:8 1304:12 1317:23 1331:19</p> <p>receives [1] 1317:6</p> <p>recent [4] 1095:10 1104:21 1280:16 1305:9</p> <p>recently [1] 1280:18</p> <p>recess [5] 1224:14,15 1276:7 1302:16 1333:7</p> <p>recognize [2] 1207:8 1209:11</p> <p>recognized [1] 1103:14</p> <p>recollection [7] 1101:24 1227:13,15 1281:3 1291:3 1307:3 1308:23</p> <p>recommending [1] 1195:16</p> <p>record [20] 1101:23 1103:10,18 1105:9 1106:7 1107:1 1194:9 1207:14 1214:3 1221:24 1222:11 1225:22 1226:7 1238:8 1262:20 1276:21 1295:13 1322:10 1326:1,17</p> <p>recordings [2] 1088:9 1194:10</p> <p>recross [1] 1365:2</p> <p>recross-examination [1] 1275:2</p> <p>redesign [1] 1256:25</p> <p>redirect [2] 1273:5 1365:2</p> <p>reduce [1] 1253:17</p> <p>reducing [1] 1233:16</p> <p>reduction [2] 1196:20 1310:12</p> <p>refamiliarized [1] 1306:5</p> <p>refer [5] 1108:22 1287:20,21 1317:24 1330:7</p> <p>refereed [2] 1281:9,14</p> <p>reference [8] 1202:12 1204:8 1208:8 1231:25 1239:1 1244:14 1284:9 1325:14</p> <p>references [1] 1105:23</p> <p>referencing [1] 1255:21</p> <p>referred [4] 1282:17 1283:20 1314:7 1328:6</p> <p>referring [1] 1308:1</p> <p>refers [1] 1317:25</p> <p>reflect [6] 1103:3 1213:18 1216:21 1220:21 1221:4 1318:4</p> <p>reflected [3] 1102:2 1103:8 1104:11</p> <p>reflecting [1] 1105:25</p> <p>reflection [1] 1237:22</p> <p>reflects [3] 1214:12,14 1238:12</p> <p>refocused [1] 1206:2</p> <p>refreshed [1] 1227:15</p> <p>regard [12] 1103:2 1198:7 1199:6 1215:17 1234:10 1246:24,24 1247:3 1253:4 1290:17 1294:9 1308:5</p> <p>regressions [1] 1099:5</p> <p>regular [3] 1202:13 1204:24 1206:4</p> <p>regulation [2] 1198:7 1261:19</p> <p>rehabilitate [1] 1099:24</p>	<p>reitman [1] 1324:13</p> <p>rejected [7] 1098:16 1101:15,20 1237:17 1238:4 1365:15 1366:1</p> <p>relates [1] 1305:8</p> <p>relating [1] 1097:2</p> <p>relation [2] 1094:13 1100:17</p> <p>relationship [2] 1098:11 1247:23</p> <p>relative [3] 1191:2 1216:17 1218:3 1231:5 1233:25 1246:12 1247:9 1314:17</p> <p>relatively [3] 1099:16 1212:13 1238:3</p> <p>relevance [3] 1218:5,7,7</p> <p>relevant [8] 1096:11 1097:14 1098:1,12 1101:14 1231:21 1301:17 1316:14</p> <p>reliability [1] 1329:9</p> <p>relied [5] 1327:4,20 1329:4 1331:24 1332:14</p> <p>rely [2] 1275:17 1330:7</p> <p>remaining [1] 1106:14</p> <p>remains [1] 1106:13</p> <p>remember [10] 1099:8 1101:10 1102:1,15 1108:12 1236:9,18 1261:7 1284:23 1300:18</p> <p>reminded [1] 1277:11</p> <p>reminder [1] 1304:14</p> <p>renew [1] 1302:10</p> <p>repeat [4] 1197:1 1217:16 1244:22 1249:4</p> <p>repeatedly [1] 1306:3</p> <p>repeating [1] 1256:12</p> <p>repertoire [1] 1191:9</p> <p>repertoires [1] 1191:6</p> <p>report [6] 1094:25 1095:1 1248:9 1252:10 1303:14 1310:4</p> <p>reported [2] 1088:25 1205:20</p> <p>reporter [1] 1367:10</p> <p>reporting [1] 1296:8</p> <p>reports [4] 1094:23 1202:20 1283:19 1301:11</p> <p>represent [6] 1229:2 1235:1 1258:14 1259:10 1289:25 1311:13</p> <p>representative [1] 1306:13</p> <p>represented [2] 1274:18,19</p> <p>reproduced [1] 1234:16</p> <p>reproduction [2] 1307:11 1314:23</p> <p>require [1] 1247:20</p> <p>required [3] 1218:11 1279:15 1291:24</p> <p>research [6] 1280:10,11 1281:7,20 1287:22 1299:15</p> <p>researchers [1] 1281:5</p> <p>respect [12] 1101:21 1193:18 1207:19 1221:20 1240:2 1247:6 1260:12,13 1285:13 1288:1,2 1310:6</p> <p>respective [3] 1218:3 1228:11 1247:6</p>
--	--	---	--

REVISED AND CORRECTED TRANSCRIPT
OPEN SESSIONS

<p>respectively [1] 1327:2 respects [1] 1191:22 respond [1] 1302:6 respondents [1] 1202:21 response [5] 1194:11 1204:3 1213:3 1240:19 1261:13 responses [5] 1203:14, 14, 16 1237:19, 22 responsibility [1] 1280:17 rest [2] 1229:4 1275:8 rested [1] 1102:3 restricted [5] 1109:9 1201:23 1202:2 1207:13 1209:3 1262:20, 22 1314:20 1333:20 result [2] 1093:9 1323:13 results [5] 1204:9 1310:20 1319: 15 1326:22 1327:14 1328:7, 9, 18 resume [3] 1094:15, 17 1100:22 resumed [3] 1276:8 1297:13 1333: 8 retail [5] 1239:5, 6 1240:12 1241:2, 11, 16, 19 1242:1, 7 retained [2] 1106:24 1295:10 return [4] 1220:3 1315:5 1321:6, 24 reveal [1] 1219:19 revenue [19] 1197:4 1232:5 1241: 9, 17 1253:17, 23 1254:2, 8 1257:22 1311:6, 14, 17 1313:24 1316:18 1317:14 1318:4, 5, 6 1323:18 revenues [4] 1233:9 1253:13 1316:21 1317:25 reverse [1] 1314:15 review [7] 1281:14, 16 1300:10 1304:6 1305:11 1323:5 1327:19 reviewed [4] 1228:1 1300:13 1302: 19 1327:4 reviewing [1] 1285:22 rewind [1] 1239:25 rhapsody [2] 1239:12 1240:3 riaa [2] 1089:7 1208:25 rich [52] 1090:3 1092:9, 20, 22, 25 1093:2 1095:23 1096:6 1190:2 1201:23, 25 1202:8 1207:12, 18 1209:2, 10, 13, 21 1211:4, 6, 10, 12 1220:7, 11 1224:5, 11 1225:25 1226:1, 2 1231:8 1243:8, 14, 21 1244:5, 9, 12, 25 1245:5, 8, 18, 19, 21 1249:22 1256:5, 7, 8 1262:18 1274: 2, 25 1275:3, 22 1320:12 right-hand [2] 1233:5 1315:14 rights [1] 1236:4 rightsholders [1] 1277:21 rigorous [1] 1101:24 risk [2] 1299:3 1314:11 rmr [1] 1088:25 roa [3] 1318:25 1319:1 1323:1 road [1] 1282:24 rochester [2] 1278:23 1286:8 role [2] 1287:14 1300:11</p>	<p>roles [3] 1287:7, 10, 23 rollin [1] 1089:21 room [2] 1262:22 1333:12 roughly [5] 1195:11 1242:4 1286: 15 1310:9 1322:6 round [1] 1102:25 row [1] 1309:16 royalties [3] 1251:4, 19, 25 royalty [20] 1088:1, 6 1241:4 1251: 9 1252:3, 4 1253:21 1255:8 1256: 22 1257:8 1258:2 1300:24 1306:7 1311:10, 12 1321:20, 24 1322:4, 13, 17 rubinfeld [1] 1226:23 rule [1] 1195:18 ruled [5] 1096:15 1273:18 1275:10 1306:10 1311:7 rules [1] 1246:23 ruling [1] 1310:24 runs [1] 1294:1</p> <p style="text-align: center;">S</p> <p>s.e [1] 1088:20 sake [1] 1289:11 sale [1] 1100:17 sales [7] 1316:18 1317:7, 7, 19 1318:8, 20 1319:10 sam [1] 1089:14 same [22] 1106:25 1107:6 1207:4, 13, 20 1226:10 1236:6 1241:14 1242:4, 11, 23 1246:6, 8, 11 1260: 3, 4 1297:17 1307:24 1309:12 1322:10 1327:15 sanitizer [1] 1092:7 santana [1] 1090:7 satellite [18] 1088:9 1190:6, 13 1192:24 1193:13, 18 1205:6 1206: 6 1210:19 1211:18 1213:19 1228: 11 1233:13 1242:25 1258:6, 19, 24 1259:23 saudi [1] 1283:7 saw [4] 1227:16 1229:6 1290:9 1293:25 saying [15] 1108:20 1219:2 1234: 17 1238:4 1252:12, 13 1254:5 1261:9 1309:1 1313:3, 7 1318:18 1319:3 1329:17, 21 says [10] 1109:1 1205:14 1206:3 1208:9 1210:11, 23 1211:14 1293: 19 1311:23 1317:7 schedule [2] 1225:5 1331:1 school [7] 1093:19, 20 1278:16 1280:2 1288:6 1291:20 1293:14 scored [2] 1286:15 1292:3 screen [11] 1089:3 1209:4 1242: 23 1290:14, 16 1296:1 1303:18 1304:18 1307:10 1314:20 1321:6 screens [1] 1288:7 scroll [2] 1289:18 1293:12 sdars [45] 1088:12 1196:19, 24</p>	<p>1197:10, 10 1226:11, 20, 23 1227: 14 1231:12, 17 1232:25 1235:8, 23 1236:4, 7, 14, 24 1237:6, 17 1238:9 1242:9, 18 1243:3 1283:16, 18 1305:5, 22 1306:1, 2, 3, 8, 9 1308:1, 10, 11 1310:2, 6, 15, 17, 19, 21 1311: 24 1312:6, 14 seated [5] 1092:4 1225:4 1276:9, 15 1302:17 1333:9 second [11] 1093:22 1192:23 1205:19 1220:2 1232:24 1245:9 1273:23, 25 1290:9 1305:8 1307: 19 secretary [1] 1291:4 secretary's [1] 1291:15 section [5] 1224:8 1276:23 1290: 16 1304:4 1307:2 sections [1] 1290:24 secured [1] 1215:20 securities [1] 1296:8 security [2] 1280:13 1298:19 see [32] 1094:11 1102:19 1190:16 1196:15 1205:16 1210:23 1211: 15 1212:8 1214:3 1223:21 1228: 23 1233:18 1237:21 1248:16 1256:2 1288:8, 17, 25 1289:13, 15, 19 1290:16 1293:12 1295:1 1296: 1 1298:1 1300:5 1318:22 1322:1 1324:20 1325:16 1327:13 seek [4] 1278:3 1328:3 1329:22, 24 seeking [2] 1262:13 1274:12 seem [2] 1196:17 1331:7 seemed [1] 1212:24 seeming [1] 1195:25 seems [2] 1195:24 1332:11 seen [2] 1252:8 1312:6 sees [1] 1099:24 segment [2] 1229:20 1262:18 selected [1] 1242:2 self-mutilation [1] 1275:4 sell [1] 1317:21 seller [3] 1219:12 1260:19 1261:1 semester [1] 1093:22 senior [2] 1107:19 1228:17 sense [11] 1105:18 1202:25 1219: 10 1221:2 1239:19 1241:18 1254: 17, 25 1259:1 1274:1 1291:15 sentence [4] 1191:18 1212:10, 11 1229:4 separate [5] 1223:4 1235:14 1286: 20 1290:16, 21 series [3] 1104:18 1237:18 1329: 22 serve [1] 1279:17 served [1] 1100:20 service [43] 1104:22 1107:17 1108: 6 1190:7 1191:7 1192:21, 24 1193: 5, 6, 7 1198:19 1203:7, 10, 20, 22 1204:10, 11 1205:8, 19 1212:8 1214:10 1220:16 1233:14 1234:1</p>	<p>1246:3 1247:22 1249:14 1250:9, 10, 12 1254:18 1258:7, 8, 10, 18, 19, 24 1259:5, 17 1260:5, 22 1279:2, 5 services [78] 1088:11 1103:11, 16, 19 1106:23 1107:21 1190:5, 13, 20, 25 1191:4, 13, 23 1192:4, 7, 13, 18 1193:11, 20 1194:8 1198:13 1199: 7, 11, 14, 17 1200:12, 19 1201:1, 5, 10, 11 1202:22 1203:1, 12 1204:12, 14, 17, 20 1205:12 1206:9, 13, 14, 19 1208:21 1210:12 1217:2 1218:4 1221:21 1223:19 1224:1 1226:8, 24 1229:2, 25 1231:24 1233:9, 14 1235:7, 20 1236:5, 6 1238:24 1239: 6, 7, 11 1241:4, 11 1242:1, 6 1246: 16, 25 1247:11, 20 1249:23 1256: 23 1293:19 1295:16 1299:10 session [5] 1109:13 1210:4 1262: 25 1333:23 1365:9 sessions [1] 1365:11 set [18] 1098:5, 7 1103:2 1104:16 1106:9 1191:21 1196:19 1198:8 1213:7, 17 1232:17 1258:2, 15 1294:18 1306:24 1323:3 1330:9 1331:2 sets [2] 1101:8 1241:1 setting [5] 1102:21, 22 1103:8 1104:11 1231:11 1292:12 settings [1] 1292:8 settle [1] 1301:10 several [5] 1100:22 1102:24 1294: 22 1299:22 1305:4 shadow [2] 1260:24 1261:19 shapiro [4] 1259:14 1305:14 1309: 19 1310:3 shapiro's [1] 1284:8 share [5] 1108:9 1210:24 1211:13 1232:4 1240:8 shared [1] 1228:9 shares [1] 1103:19 sheet [1] 1237:25 shift [5] 1251:18 1252:2, 8, 10 1276: 6 shopper [1] 1198:1 short [2] 1223:8 1238:2 short-term [1] 1254:8 shorten [1] 1257:3 shouldn't [2] 1209:6 1282:10 show [6] 1105:12 1242:19 1246:9, 11 1315:1 1331:6 showed [1] 1242:18 shown [2] 1214:11 1218:3 shows [2] 1208:12 1314:22 sic [5] 1315:15 1321:7, 14, 25 1324: 6 1325:11 side [3] 1205:2 1280:21 1288:16 sidley [1] 1089:23 sign [1] 1225:19 signature [3] 1303:17, 20 1367:10 significant [10] 1193:1 1195:13</p>
--	---	---	---

REVISED AND CORRECTED TRANSCRIPT

OPEN SESSIONS

<p>1196:5 1198:15,18 1200:11,23 1201:3 1214:17 1233:24 significantly [2] 1197:20,21 silly [1] 1293:18 similar [6] 1191:24 1199:20 1258: 19 1259:13 1261:11 1315:19 similarities [3] 1227:3 1246:9 1258:22 similarity [1] 1231:10 similarly [4] 1099:4 1204:22 1218: 10 1235:11 simple [4] 1097:8 1253:11 1254:6 1256:14 simply [21] 1190:19 1200:6 1231: 22 1232:19 1256:18 1286:24 1292:18 1293:23 1296:16 1297:4 1307:18 1308:23 1309:16 1310: 10,21 1311:17 1316:21 1317:20 1329:3 1330:25 1331:8 simpson [1] 1274:17 since [18] 1104:15 1108:10 1109:8 1202:3 1205:3 1209:14,16 1225:6, 21 1227:16 1245:16 1261:4 1280: 15 1294:19 1305:10 1312:3 1313: 12 1331:12 singer [1] 1090:4 single [1] 1253:21 sir [42] 1093:16,21 1095:7 1100:14 1102:6 1103:6,13 1104:8,14 1106: 19 1108:19 1190:9,17 1192:1,5 1198:16 1199:21 1200:4 1201:14 1202:11,19 1203:3,25 1205:17 1208:1,11,16 1209:12,25 1210:10, 21 1213:25 1223:22 1228:24 1229:11 1233:19 1236:2,18 1239: 3 1242:23 1245:10 1251:22 sirius [112] 1090:2 1190:19 1191:8, 13,23 1192:3,13,17,21 1193:10 1194:4,21 1195:8,10,17 1196:22 1197:18 1198:12,18,24 1199:10, 17 1200:11 1201:4 1207:21 1212: 6,14 1215:20 1216:14,15 1223:20 1229:6 1232:5 1233:13 1234:1 1237:16 1239:16 1240:18 1241: 22 1243:3 1246:2,20 1247:3,7,13, 16,19 1248:6,10,16 1249:11,13,20 1250:21 1251:11,15,17,19,23 1253:8,23 1254:7 1255:3,24 1256: 15,17 1257:10,16,17,21 1258:6,18, 19 1259:3,17,21 1260:14,17 1261: 17,20 1262:16 1276:18 1278:1 1305:9 1308:18 1314:1,10,17 1317:10,14 1321:10,19,23 1322:3, 16,24 1323:5,9,16,22 1326:20 1327:24 1328:19 1329:6,10,17 1330:12 1332:9,22,24 1333:16 sirius's [1] 1199:6 site [12] 1095:13 1202:4 1288:6,9 1289:10 1291:2 1292:23 1293:9 1294:2 1295:25 1296:17,23</p>	<p>sitting [5] 1207:23 1234:15 1242: 12 1255:1,18 situation [2] 1219:4 1221:7 six [1] 1261:25 skill [2] 1302:24 1367:4 skim [1] 1324:2 skip [4] 1239:25,25 1240:17 1259: 2 slacker [2] 1239:13 1240:3 slate [1] 1105:18 slide [29] 1202:20 1204:7,15,21 1205:10,23 1206:3 1208:2,17 1209:22 1210:1,16,23 1211:5 1217:11 1220:12,14 1223:16 1232:1,11 1234:16 1238:2,8,12,16 1239:2,13 1241:1 1247:1 slides [5] 1227:20 1232:22 1237: 15 1276:24 1277:4 slight [1] 1239:18 slightly [6] 1104:24 1222:23 1234: 24 1235:7 1240:24 1258:23 slowly [1] 1280:15 slyly [1] 1252:20 small [2] 1250:15,17 smartphone [1] 1259:18 so-called [1] 1097:5 social [2] 1093:4 1280:17 softer [1] 1280:21 solution [1] 1256:14 somebody [1] 1222:11 someone [2] 1216:12 1239:24 sometime [2] 1094:23 1237:12 sometimes [5] 1198:2 1282:15,17 1283:20 1314:7 somewhat [2] 1212:25 1227:15 somewhere [3] 1235:12 1273:9 1286:4 sony [1] 1089:20 sorry [17] 1109:7 1205:24,25 1208: 6 1210:7,8 1211:10 1220:10 1256: 5 1284:6 1294:24 1298:25 1305: 19 1312:5 1319:4 1332:2,5 sort [4] 1095:15 1106:11 1211:9 1333:6 sought [4] 1197:12,13 1274:12 1326:11 sound [7] 1088:8 1194:10 1221:18 1222:19 1226:17 1238:19 1246:2 soundexchange [18] 1089:2 1106:25 1208:4 1209:19 1226:9 1228:4 1251:25 1253:10 1255:16 1257:11,13 1259:22 1277:20 1278:8 1295:11 1331:18 1365:18 1366:2 sounds [2] 1225:14 1312:25 source [1] 1207:25 sources [1] 1199:5 south [1] 1283:12 southern [1] 1101:5 speaking [1] 1253:7</p>	<p>speaks [2] 1310:5 1329:12 special [1] 1292:12 specialized [1] 1294:11 specialties [2] 1290:25 1300:18 specific [6] 1109:8 1243:23 1244: 10 1288:22 1292:7 1301:16 specifically [6] 1208:20 1210:11 1243:5 1244:7 1247:5 1285:13 specifics [1] 1226:19 specified [1] 1098:3 speculate [1] 1099:1 speculating [1] 1253:1 speculative [1] 1098:21 spent [3] 1210:2,17,18 sponsor [1] 1204:1 sponsoring [4] 1327:17 1328:20 1330:3,11 spotify [10] 1203:8,9 1204:2,8 1237:10,11 1248:2 1250:1,24 1251:8 spotify's [3] 1204:10 1250:2,14 sprinkled [2] 1105:22 1212:18 squarely [1] 1300:19 stable [1] 1318:19 staff [3] 1228:13,16,17 stages [1] 1298:13 stamp [1] 1208:3 stand [2] 1275:12 1331:10 standard [2] 1279:22 1282:7 stanford [4] 1280:5,6 1282:2,22 staples [5] 1274:7,11,14,19 1275: 5 start [7] 1106:21 1217:14 1249:5,8 1282:6 1285:21 1297:25 started [3] 1228:8 1229:14 1305:6 starting [4] 1105:18 1238:25 1281: 10 1307:3 starts [3] 1284:16 1314:17 1317: 11 state [5] 1100:8 1106:22 1190:11 1237:6 1238:6 stated [1] 1300:22 statement [3] 1243:10 1244:8,11 statements [1] 1102:20 states [6] 1088:1 1089:3 1095:24 1286:8 1315:17 1327:14 statistics [2] 1299:20 1324:16 status [1] 1279:15 statutorily [1] 1104:16 statutory [11] 1198:7 1215:22 1216:15 1236:16 1238:14 1258: 11 1260:22,24 1310:22 1314:13, 16 stay [4] 1215:25 1287:4 1332:25 1333:16 steer [2] 1218:5 1308:19 steering [16] 1106:12,16 1108:8, 22 1215:1,7,17 1216:18,23,24 1217:12,24 1218:14 1219:20 1237:2 1308:17</p>	<p>stenographic [1] 1367:5 steps [1] 1234:8 steven [1] 1089:9 stick [1] 1216:11 still [12] 1202:13 1206:23 1216:4 1227:12 1279:9 1280:5,7 1284:22 1317:22 1319:8,21 1320:14 stints [1] 1093:15 stopped [2] 1198:24 1234:21 strands [1] 1294:7 strategy [1] 1319:12 stream [1] 1208:14 streamers [3] 1211:1,15,22 streaming [19] 1190:13 1200:7 1201:10,11 1203:9 1204:20 1205: 7,8,18,19 1206:6,13,13 1210:1,9, 18 1211:17,18 1248:16 streams [2] 1192:8 1194:9 street [3] 1089:24 1090:15 1091: 13 stress [3] 1314:7 1322:11,12 stricken [1] 1277:6 strickler [66] 1088:16 1108:18 1211:2,8 1213:4 1219:2,18 1220: 3,6,9 1228:20,25 1229:12 1230:4, 8,14,24 1231:2,7 1244:21 1245:1, 6 1248:14 1249:21 1262:6,17 1290:8 1291:14,25 1293:1,4 1294: 6,14 1295:6 1307:25 1308:8,15,25 1309:6 1311:19 1312:4,17,23 1313:6,21 1316:4,9,12,15 1317:1, 23 1318:3,9 1319:3,23 1320:1,5,8, 16 1326:5,9 1328:5 1329:16 1330: 12 1331:21 1332:4 strickler's [1] 1318:22 strike [1] 1276:22 strong [2] 1227:13 1281:22 structure [7] 1255:8 1256:22 1257: 1,5,9 1258:3,3 students [2] 1279:9 1286:15 studied [4] 1107:3 1258:21 1308: 21 1310:14 study [10] 1102:10 1198:22 1201: 20 1202:9 1207:2,8 1208:25 1215: 11,15 1313:20 studying [1] 1216:4 styled [1] 1095:24 sub [2] 1197:5,6 sub-branch [1] 1301:13 sub-discipline [1] 1293:8 subheading [2] 1210:24 1290:21 subject [7] 1098:11 1100:24 1214: 25 1219:5 1231:2 1304:1,5 subjects [2] 1258:5 1279:19 submissions [2] 1302:21,22 submit [1] 1096:17 submitted [3] 1095:5 1283:19 1302:19 subscribe [3] 1193:25 1194:1 1254:9</p>
---	--	---	--

REVISED AND CORRECTED TRANSCRIPT
OPEN SESSIONS

<p>subscriber [12] 1193:9 1212:13 1247:14,17 1250:2,19,25 1259:8,16 1260:3 1262:10 1308:5</p> <p>subscribers [15] 1190:15 1247:7,8 1248:11,18,20 1250:21,22 1255:12 1259:23 1311:16 1316:24,25 1318:2 1320:24</p> <p>subscribing [1] 1239:24</p> <p>subscription [46] 1088:11 1103:11 1104:17 1190:4 1191:23 1192:3,12,17 1193:4,15 1198:19 1199:17 1200:12,18 1201:4 1204:10,14,17 1205:4,6 1206:18 1208:21 1210:12 1221:21 1222:24,25 1223:19 1224:1 1226:8 1229:2 1231:24 1233:9,14,17 1235:20 1236:5 1238:24 1239:6,7 1241:4 1246:19,20 1250:11,16 1258:7 1259:4</p> <p>subscription-based [2] 1206:9 1223:15</p> <p>subscriptions [1] 1248:15</p> <p>subsections [1] 1290:14</p> <p>subsequent [1] 1309:16</p> <p>subsidiaries [3] 1289:5,23 1290:3</p> <p>substantially [1] 1096:10</p> <p>substantive [1] 1225:16</p> <p>substitute [1] 1292:17</p> <p>substitution [2] 1246:13 1257:23</p> <p>suffice [1] 1215:8</p> <p>sufficient [2] 1096:17 1329:8</p> <p>sufficiently [2] 1198:11 1199:16</p> <p>suggest [11] 1106:9 1195:21,25 1196:16 1197:3 1215:7 1232:8 1235:4,12 1251:17 1256:14</p> <p>suggested [1] 1307:2</p> <p>suggesting [3] 1196:6,15 1222:3</p> <p>suggestion [1] 1251:19</p> <p>suggests [3] 1312:7,8,10</p> <p>suite [2] 1089:17,24</p> <p>sullivan [1] 1091:4</p> <p>sum [1] 1260:9</p> <p>summa [1] 1286:6</p> <p>summarize [2] 1102:23 1238:2</p> <p>summarizes [1] 1220:14</p> <p>summary [2] 1288:12 1296:5</p> <p>summer [1] 1093:18</p> <p>sunk [1] 1282:9</p> <p>supply [1] 1274:10</p> <p>support [7] 1097:1 1099:5 1192:6 1199:22 1201:15 1235:22 1305:14</p> <p>supports [1] 1210:17</p> <p>suppose [1] 1333:1</p> <p>supra [1] 1215:9</p> <p>surprise [1] 1233:22</p> <p>surprised [1] 1292:25</p> <p>survey [7] 1202:21 1204:8 1205:11 1206:15 1207:19,25 1232:7</p>	<p>survive [1] 1325:4</p> <p>sustainable [1] 1195:23</p> <p>sustained [1] 1245:20</p> <p>suzanne [1] 1088:14</p> <p>switch [1] 1203:22</p> <p>switzerland [2] 1278:21 1283:9</p> <p>sworn [2] 1092:14 1276:13</p> <p>system [4] 1208:15 1252:15 1253:25 1258:4</p> <p>systems [2] 1287:12,18</p> <p style="text-align: center;">T</p> <p>tab [3] 1209:1 1232:25 1242:24</p> <p>table [2] 1247:1 1252:9</p> <p>tailored [1] 1191:5</p> <p>talked [7] 1108:11 1213:4 1217:6,21 1237:1 1240:18 1273:11</p> <p>target [9] 1106:15 1213:19 1214:6,16 1218:4,9,18 1219:19 1230:19</p> <p>task [1] 1316:7</p> <p>taught [13] 1279:19,21 1280:3,4,5,6,7 1282:20,20,22 1287:22 1288:13 1294:21</p> <p>teach [2] 1093:20 1280:8</p> <p>teaching [3] 1093:15 1280:5,7</p> <p>team [1] 1244:13</p> <p>technically [1] 1190:21</p> <p>television [6] 1089:4 1315:25 1324:7,10,10,16</p> <p>televisions [1] 1324:19</p> <p>tells [2] 1316:18 1317:17</p> <p>tempered [1] 1213:19</p> <p>ten [3] 1234:22 1282:23 1333:4</p> <p>tend [3] 1257:19,21 1305:19</p> <p>tended [1] 1233:10</p> <p>tenets [1] 1282:16</p> <p>term [4] 1193:20 1220:16 1226:16 1247:22</p> <p>termed [1] 1234:18</p> <p>terms [22] 1088:7 1097:9 1101:14 1109:8 1190:14 1191:5 1192:18,24 1193:17 1231:4,6 1234:20 1240:6 1247:22 1249:16 1262:9 1281:2 1287:24 1312:14 1321:24 1322:5 1323:9</p> <p>terrestrial [1] 1321:11</p> <p>terrible [2] 1324:22,24</p> <p>territory [1] 1312:16</p> <p>test [6] 1097:5,8,16,21 1322:11,12</p> <p>tested [1] 1213:13</p> <p>testified [12] 1092:14 1093:3,15 1094:8 1097:1,6 1098:25 1227:10,11 1275:16 1276:14 1310:4</p> <p>testify [7] 1203:24 1275:7,9 1301:8 1327:24 1328:16 1330:5</p> <p>testifying [2] 1313:17 1331:3</p> <p>testimonial [2] 1095:10 1100:6</p> <p>testimonies [1] 1228:11</p> <p>testimony [76] 1094:3 1095:6,14,16 1096:22 1098:10 1105:23</p>	<p>1107:12,16 1108:12 1190:11 1191:21 1195:3,13 1199:24 1202:10,10 1204:2 1208:7 1210:16,20 1211:25 1212:4 1215:7,19 1216:5 1217:4,7,10 1220:13 1223:9 1225:12 1226:17 1227:1,24 1228:1,6,8,22 1231:18 1235:17 1236:1 1242:16,25 1243:2,12,25 1245:15,22 1246:1 1247:4 1251:16,21 1255:10,22 1262:4 1275:14 1276:23 1277:14 1283:25 1284:8,8,12 1285:25 1302:4 1303:12,25 1304:19 1305:15 1306:5 1307:12 1312:12 1314:24 1318:14,15 1325:9</p> <p>tests [1] 1299:16</p> <p>texas [1] 1100:9</p> <p>thatcher [1] 1274:17</p> <p>theirs [1] 1253:24</p> <p>theme [1] 1236:12</p> <p>themselves [3] 1310:5 1318:24 1333:6</p> <p>theory [3] 1282:6,17 1298:7</p> <p>there's [12] 1193:23 1197:16 1198:15,18 1199:15 1200:11 1210:25 1213:5 1219:20 1221:17 1222:2 1223:7</p> <p>thereafter [1] 1279:3</p> <p>therefore [2] 1230:5 1317:21</p> <p>they've [2] 1193:3 1205:3</p> <p>thinking [2] 1313:10 1332:2</p> <p>thinks [1] 1309:20</p> <p>third [5] 1223:16 1283:15,17 1305:10 1324:1</p> <p>thomas [3] 1276:12 1278:15 1365:5</p> <p>though [5] 1214:8 1237:22 1240:2 1284:23 1304:15</p> <p>three [10] 1101:7 1201:16 1239:15 1260:2 1278:2,7 1283:25 1315:2,10,22</p> <p>three-part [1] 1249:1</p> <p>throughout [2] 1105:22 1212:18</p> <p>tier [7] 1249:24 1250:2,15,16 1251:1,13,15</p> <p>title [5] 1202:17 1287:19 1299:7 1326:3 1327:12</p> <p>titled [3] 1202:13 1204:23 1288:17</p> <p>titles [2] 1287:24 1327:15</p> <p>today [12] 1105:6,19,20 1207:23 1220:25 1235:8 1240:19 1255:1,18 1302:18 1304:22 1305:5</p> <p>today's [2] 1095:9 1307:6</p> <p>todd [1] 1090:5</p> <p>together [4] 1193:11,17 1194:5 1294:7</p> <p>tolin [21] 1090:13 1276:17,18 1277:9,10,15 1285:5,18 1293:2 1295:7 1297:7 1304:1 1325:25 1326:7,15,18 1327:11 1328:10 1329:21 1330:14,19</p>	<p>tomorrow [3] 1225:7 1285:12 1304:24</p> <p>ton [1] 1316:23</p> <p>toof [1] 1091:11</p> <p>took [4] 1259:7 1291:25 1311:14 1333:3</p> <p>tool [2] 1296:15 1297:4</p> <p>top [3] 1202:14 1233:2 1280:25</p> <p>topic [6] 1107:22 1190:3 1212:15 1261:4 1295:8 1306:3</p> <p>topics [2] 1304:18,21</p> <p>total [1] 1250:17</p> <p>touts [1] 1204:22</p> <p>towards [3] 1193:19 1194:9 1196:11</p> <p>track [1] 1227:3</p> <p>traditional [2] 1280:11 1295:3</p> <p>training [2] 1288:12 1302:25</p> <p>transaction [3] 1220:22 1221:4,6</p> <p>transcript [2] 1290:10 1367:4</p> <p>transition [1] 1279:9</p> <p>translating [1] 1311:17</p> <p>transmission [2] 1088:8 1193:24</p> <p>transmits [1] 1233:15</p> <p>treatment [2] 1246:2,7</p> <p>trend [2] 1293:3 1321:1</p> <p>trended [2] 1210:24 1211:14</p> <p>trends [1] 1104:7</p> <p>trepp [1] 1089:11</p> <p>trial [32] 1094:24 1095:3,7 1109:12 1201:19 1207:1,21 1209:1 1246:17,19,20 1247:7,7,14,19,22 1248:3,15,18,19,25 1250:7,19,22 1251:4,8 1255:3,11 1256:25 1262:24 1275:6 1333:22</p> <p>trialers [2] 1250:25 1253:22</p> <p>trials [25] 1245:23 1246:3,3,24 1247:3 1251:12,18,24 1252:6,7,11,11,23 1253:3,12,18,24,25 1254:11,22,23 1256:22 1257:14,19,21</p> <p>tribunal [1] 1301:3</p> <p>tries [1] 1315:16</p> <p>true [17] 1101:1 1220:24 1226:12 1239:17 1243:18 1258:13,25 1259:16 1277:15 1286:19,24 1287:15,19 1288:3 1328:11,12 1367:3</p> <p>truth [1] 1331:12</p> <p>try [3] 1282:4 1283:2 1329:24</p> <p>trying [14] 1191:16 1219:15 1230:19 1238:2 1243:19 1244:5,12 1291:5 1294:6 1312:25 1313:4,7,8,9</p> <p>turn [13] 1102:18 1190:3 1198:23 1207:1 1209:24 1220:12 1221:16 1230:1 1233:1,3 1237:15 1257:12 1303:16</p> <p>turned [2] 1211:18 1251:12</p> <p>turner [1] 1089:12</p> <p>turning [4] 1205:10 1211:17 1221:</p>
---	--	--	---

REVISED AND CORRECTED TRANSCRIPT
OPEN SESSIONS

<p>14 1240:25 turns [1] 1281:22 tv [1] 1321:8 two [30] 1096:17 1099:6 1101:11, 18 1190:6 1220:24 1223:12 1227: 17 1231:10 1232:19 1241:1 1244: 17 1261:10,25 1274:10 1279:1,9 1280:18 1290:24 1294:6 1295:22 1296:22 1301:7 1305:14 1308:18 1314:12 1315:22 1318:6 1328:18 1332:3 two-sentence [1] 1097:10 twofold [1] 1197:2 type [1] 1215:15 types [1] 1190:7 typos [2] 1225:15,22</p> <hr/> <p>U</p> <p>ultimately [3] 1096:18 1275:9 1323:19 unaware [1] 1231:9 under [10] 1210:23 1215:22 1218: 12 1232:13 1235:3 1240:4 1250: 20,22 1251:10 1253:14,15 1259: 15 1260:14 1261:15 1287:6 1290: 2 1292:4 1296:5 1297:25 undergirds [1] 1217:23 underlying [8] 1220:21 1221:4,5 1238:18 1246:8 1286:12 1291:21 1299:8 underpayment [1] 1283:21 underpinning [1] 1294:15 underpinnings [2] 1294:16,17 understand [7] 1107:5,9 1221:19 1241:21 1259:5 1286:10 1322:15 understanding [5] 1223:2 1239: 23 1279:17 1321:10 1330:19 understood [2] 1096:13 1329:17 undertaking [1] 1102:9 undertook [1] 1240:11 undone [1] 1196:8 unfair [1] 1279:10 united [5] 1088:1 1089:3 1095:24 1286:8 1315:17 universal [1] 1089:6 university [9] 1278:17,21,22 1279: 15 1280:4 1286:3,7 1290:17 1291: 9 unlike [2] 1233:14 1247:19 unmoor [1] 1313:7 unmoored [1] 1101:23 unobjected [1] 1304:10 unopposed [4] 1225:12,19,23 1278:4 unpaid [7] 1251:18,24 1252:7,11 1253:22 1254:13,23 unprofitable [1] 1098:1 unradio [2] 1239:12 1240:3 unsupported [2] 1101:23 1222:16 untethered [1] 1102:4</p>	<p>until [3] 1277:7 1287:14 1331:6 up [33] 1099:18,19 1106:16 1209:4 1212:15 1216:5,10 1217:11 1225: 16 1232:19 1242:22 1245:13 1258:2 1262:9 1277:3 1287:15 1288:5 1295:24 1301:8 1303:18 1306:3 1307:2 1312:14,16 1313: 23 1314:14 1316:20 1317:12 1320:15 1322:13 1331:2,6 1332: 15 upcoming [3] 1207:21 1235:24 1326:21 update [1] 1225:6 updated [3] 1094:17 1305:6 1329: 11 upside [1] 1257:12 upstream [3] 1103:15 1108:23 1226:6 usc [1] 1093:23 using [10] 1194:12,19 1198:24 1205:5 1211:16 1218:18 1220:20 1221:3 1234:11,11 1246:16 1249: 10,12 1250:2 1262:12 1321:2 utilized [2] 1238:9,10</p> <hr/> <p>V</p> <p>vacuum [1] 1195:6 vague [1] 1291:3 validate [2] 1198:13,13 validated [1] 1104:10 valuable [1] 1212:13 valuation [1] 1230:18 value [9] 1099:7 1196:20 1203:21 1212:6 1230:19 1232:4 1292:11 1312:14 1332:15 variable [3] 1317:6 1319:14,15 variety [1] 1293:15 various [8] 1100:25 1107:14 1199: 5 1202:22 1212:22 1221:25 1288: 13,23 vast [1] 1250:20 vehicle [1] 1327:20 venture [1] 1280:1 version [1] 1097:10 versus [7] 1095:24 1237:1 1247:7 1249:6 1255:19 1274:6 1324:16 via [1] 1193:6 viable [1] 1197:22 video [1] 1229:17 view [12] 1199:15 1207:24 1215:3 1217:24 1222:14 1227:12 1250: 11 1259:21 1260:13 1261:3,8,20 views [1] 1220:14 violating [1] 1291:8 virtually [2] 1291:18 1301:15 virtue [3] 1329:3 1331:1,8 visited [1] 1289:9 visiting [1] 1280:6 vitae [5] 1094:7 1100:6 1284:15 1297:23 1302:20</p>	<p>voir [4] 1285:10,16,17 1365:6 volume [1] 1088:24 voluntary [1] 1299:10</p> <hr/> <p>W</p> <p>wait [2] 1262:23 1277:7 waived [1] 1329:1 walk [2] 1201:18 1305:1 walk-away [1] 1260:21 wanted [3] 1221:8 1225:8 1276:21 wants [2] 1097:11 1292:22 warner [1] 1089:6 warrant [3] 1104:22 1199:18 1217: 17 warranted [6] 1106:13 1214:2,7 1217:24 1218:15 1310:13 warren [38] 1089:15 1276:16 1277: 17,20 1278:10,12 1285:1 1297:9, 12,14 1302:8,15 1303:4,7,8,23 1304:9,14,16 1309:8 1313:22 1318:12 1320:17 1325:6 1326:10, 25 1327:8 1328:4,23 1330:25 1331:20,25 1332:7,18,19 1333:11, 14,18 washington [3] 1088:21 1089:18 1091:14 way [21] 1099:22 1101:11,18 1102: 25 1193:21 1194:19 1204:1,7 1208:4 1219:24 1221:15 1222:4 1245:12 1248:24 1255:19 1259:7 1287:15 1290:6 1301:21 1313:10 1325:14 way-half [1] 1262:1 ways [3] 1192:11,16 1314:12 wazzan [1] 1225:12 web [30] 1095:12 1103:14 1104:9, 16 1105:8,14 1107:1,7,25 1108:10 1202:3 1221:20 1222:22 1223:24 1226:11,24 1238:10 1258:15 1283:17 1284:22 1288:5,9 1289: 10 1291:2 1292:23 1293:9 1294:2 1295:25 1296:17,23 webcasters [2] 1104:17 1258:12 webcasting [5] 1258:7,18 1259:5, 17 1260:4 week [1] 1291:7 weight [1] 1329:12 weighted [2] 1239:21 1241:13 weil [5] 1090:8,14 1274:18,21 1276:18 westlaw [2] 1095:25 1096:1 whatever [4] 1213:20 1229:6 1253:22 1309:4 wheeler-frothingham [1] 1091:5 whenever [1] 1251:4 whereas [2] 1215:6 1247:21 whereupon [6] 1092:11 1109:12 1224:15 1262:24 1276:11 1333: 22 wherever [1] 1277:22</p>	<p>wherewithal [1] 1195:15 whether [29] 1097:22,23 1107:3, 19,25 1195:22 1197:14,16 1203:4, 13,22 1206:18 1214:11 1215:1 1223:3 1229:23 1234:21 1237:13 1244:23 1247:24 1248:16 1261: 14 1292:14 1308:15,19 1311:9,21 1313:16,24 white [1] 1307:19 whole [4] 1198:1,3,6 1244:13 whom [4] 1107:19 1275:18,20 1300:21 widgets [1] 1317:21 will [41] 1109:4,10 1209:5 1219:13 1225:7 1227:22 1229:3,20 1232: 10 1233:4 1235:1 1241:13 1242: 23 1245:19 1246:15 1258:14 1259:9 1262:21 1273:3 1277:4,8 1279:2 1289:13 1290:6 1292:16 1304:6 1318:9 1319:1 1323:7 1325:4 1327:13,24 1328:19 1329: 18,20,23 1330:21 1331:3,11 1332: 9 1333:5 willig [3] 1199:3,13 1246:15 willing [3] 1219:11 1260:19 1261: 1 willingness [1] 1223:10 window [1] 1312:1 winston [1] 1230:12 withdraw [1] 1209:13 within [8] 1102:8 1106:18 1249:10 1260:25 1288:23 1290:3,17 1293: 15 without [8] 1102:8 1219:8 1244:14, 15 1286:25 1291:8 1310:6 1316: 18 withstand [1] 1195:15 witness [78] 1092:10,13,18 1096:5 1108:24 1219:7,24 1220:5 1228: 24 1229:11,14 1230:7,12,15 1231: 1,4 1243:6,22,24 1244:8,11,12,23 1245:9 1248:23 1262:8 1274:13 1276:1,3,10 1277:18 1290:22,25 1291:18 1292:2 1294:13,18 1302: 23 1305:24 1306:2 1308:7,13,21 1309:5,7 1311:25 1312:15,18 1313:4,8 1316:8,11,13,17 1317:4 1318:1,5,11 1319:5,25 1320:4,7, 10 1324:8,11,17,21 1325:1 1326: 19 1327:17 1328:19,21,22 1329: 23 1330:3,11 1331:24 1365:2 witnesses [9] 1207:21 1327:25 1328:2 1329:15,18 1331:2,3,6,9 word [2] 1280:21 1299:6 words [8] 1093:6 1096:12 1099:10 1102:1,6,15 1104:1 1216:3 work [10] 1094:12,21 1208:4 1227: 11 1237:14 1241:14 1244:15 1261:7 1296:24 1332:9 workable [1] 1260:18</p>
--	---	--	--

REVISED AND CORRECTED TRANSCRIPT

OPEN SESSIONS

workably [2] 1260:15 1261:15
 worked [3] 1274:5 1295:21,22
 workers [2] 1319:16,17
 working [1] 1284:17
 workingly [2] 1107:18 1108:6
 workings [2] 1103:3 1213:18
 works [1] 1288:4
 world [2] 1102:4 1229:18
 worldwide [1] 1283:6
 worth [1] 1254:8
 write [2] 1229:1 1303:14
 writes [1] 1296:6
 writing [1] 1228:8
 written [40] 1095:5,14 1105:22
 1107:16 1190:10 1191:21 1199:
 24 1202:10 1208:7 1210:15 1212:
 4 1215:6,19,24 1216:4 1217:4,5,
 10 1226:16 1227:24 1228:5,8,21
 1235:17 1242:25 1245:25 1247:4
 1251:16 1255:10,21 1283:25
 1284:12 1285:25 1303:11,25
 1304:8,19 1307:11 1314:23 1325:
 9
 wrote [5] 1213:9 1273:20 1293:6
 1298:18 1301:11

X

xm [80] 1090:2 1190:19 1191:8,13,
 23 1192:3,14,17 1194:4 1195:8,10
 1196:22 1197:18 1198:12,18,24
 1199:10,17 1200:11 1201:4 1212:
 6,14 1215:20 1216:14,15 1223:20
 1229:6 1232:5 1233:13 1234:1
 1237:16 1239:16 1240:18 1241:
 22 1243:3 1246:3 1247:3,7,17,19
 1248:16 1250:21 1251:11,17,19
 1253:8 1254:7 1255:24 1256:15,
 17 1257:10,16,17,21 1258:6 1259:
 3,21 1260:17 1261:20 1262:16
 1278:1 1305:9 1308:18 1314:10,
 17 1317:10,14 1321:11,23 1322:3,
 16,24 1323:9 1326:20 1329:6,10,
 18 1330:12 1332:9 1333:16
 xm's [22] 1192:21 1194:22 1195:
 17 1207:21 1246:20 1247:14
 1248:6,11 1251:24 1255:3 1258:
 18,19 1259:17 1260:14 1314:1
 1321:19 1323:5,16,23 1329:6
 1332:22,24

Y

year [11] 1095:21 1096:4 1196:25
 1231:16 1245:15 1279:1 1286:14
 1307:17,24 1326:22,24
 years [12] 1193:7 1220:25 1250:5
 1278:25 1279:1 1280:19,24 1282:
 24 1294:10 1326:21 1327:1 1331:
 15
 yes-or-no [1] 1203:3
 yesterday [14] 1108:12 1195:1

1199:1 1212:16 1213:4 1220:13
 1225:6 1232:1,6,12 1237:16 1239:
 10 1241:8 1249:4
 yesterday's [1] 1095:8
 yielded [1] 1236:15
 york [7] 1089:17 1090:10,10 1091:
 8,8 1101:6 1274:1
 youngest [1] 1279:25
 yourself [1] 1278:14

Z

zero [4] 1214:16 1217:22,22 1253:
 16
 zeroed [1] 1229:24
 zone [2] 1236:17 1238:15